

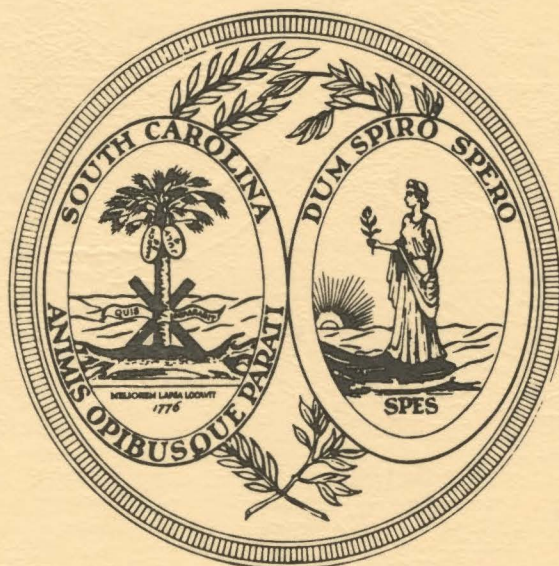
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Legislative Audit Council



South Carolina General Assembly
Legislative Audit Council
Program and Operational Review
of the South Carolina
Public Service Commission
April 18, 1977

South Carolina General Assembly
Legislative Audit Council
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THE STATE OF SOUTH CAROLINA
GENERAL ASSEMBLY
LEGISLATIVE AUDIT COUNCIL
PROGRAM AND OPERATIONAL REVIEW
OF THE
SOUTH CAROLINA
PUBLIC SERVICE COMMISSION

The Legislative Audit Council wishes
to acknowledge the assistance and cooperation
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REPORT SUMMARY

During this audit the Council identified several characteristics which it feels must be present if the regulatory system in South Carolina is to be truly effective. First, the philosophy upon which the system is based must emphasize the importance of providing the best possible level of service for the lowest possible cost.

Second, the system must enable the Public Service Commission to be independent of special interests, representative of the people it serves, and well informed as to the issues involved in rate cases and the needs of the people. It must be structured and operated in such a way as to instill public confidence.

In addition, rate case decisions must be based on accurate and objective information developed and/or verified independent of parties to the rate case. Finally, the system must ensure that the parties to the rate case (utilities and consumers) are equally represented and informed, and that both are confident that the rate decision provides for their needs equally.

In general, the Public Service Commission was found to have made significant efforts to operate more effectively during the past five years of increased regulatory activity. However, the Council identified weaknesses in the Commission's operations and found that the regulatory system within which the Commission must function places severe limitations on the ability of the Commission to serve the public interest effectively.

These systemic problems were also found to reduce the Commission's ability to achieve the desirable characteristics outlined above, thus reducing its effectiveness as a regulatory body. Much of the Council's effort was directed toward identifying and analyzing these systemic limitations and a major portion of this report consists of findings and recommendations resulting from this effort.

This summary provides the reader with a brief list of the conditions found and factors considered by the Legislative Audit Council while conducting this audit. Also included are summaries of the major findings of the report keyed to the pages on which they can be found.

CONDITIONS AND FACTORS

Public Electric Utilities in South Carolina:

- are monopolies;
- provide essential services to consumers;
- have vast resources in both funds and expert assistance to support their requests for rate increases;
- are the sole suppliers of the majority of information upon which rate decisions are made;
- are currently a safe and profitable investment for stockholders.

Consumers in South Carolina:

- are only able to purchase electricity from one designated utility and at a designated price over which they have little control;

- provide the financial resources that enable utility companies to support their requests for rate increases;
- are seldom in a position to undertake effective and unified action to oppose rate increases because they are not a cohesive interest group;
- do not have the resources to obtain the legal and technical assistance necessary to effectively oppose rate increases;
- are generally unable to understand the complexities of rate case procedures;
- are not directly involved in the selection of Public Service Commissioners.

The South Carolina Public Service Commission:

- is not able to develop adequate amounts of independent and objective information of its own and therefore must rely, to a great extent, on company prepared data for rate cases;
- does not emphasize the analysis of the management efficiency of utilities;
- does not collect adequate information concerning the needs of the consumers.

SUMMARY OF FINDINGS

Need for Increased Emphasis on Efficiency in Rate-making (P. 37).

The Public Service Commission is unable to independently determine the level of efficiency in utility companies and the current philosophy of the Commission does not emphasize the importance of such analysis.

The regulatory approach used by the Commission tends to cause utility regulation to drift away from its central purpose of ensuring efficient utility operation and the lowest possible price for electrical service.

Lack of Independent and Objective Information for Decision-making (P. 40).

The majority of information used by the Public Service Commission for rate-making purposes is supplied directly by the utilities themselves. While much of this data is verified through auditors, some could be biased and interpreted by the company to best support its position. This is not inappropriate for companies who are in business to make a profit. However, a higher level of objectivity could be achieved if the Public Service Commission developed information necessary for rate decisions independently whenever possible.

Inadequate Legal Representation of Consumers (P. 43).

The average consumer is not provided adequate legal representation in Public Service Commission rate proceedings. Utility companies are able to retain high quality legal expertise and expert testimony while the public of South Carolina is not provided comparable assistance and representation.

Lack of Information Concerning Consumer Interest and Commission Activities (P. 46).

The Public Service Commission does not collect adequate information concerning the needs of the consuming public. In addition, the public is not adequately informed as to the activities and regulatory priorities of the Commission.

Need for Generation/Purchase Mix Studies (P. 59).

The Council found that studies of generation/purchase mix were needed to ensure that consumers are getting the benefit of the lowest priced energy and to ensure that generation/purchase mix is efficiently managed by utilities.

Lack of Adequate Written Administrative Procedures (P. 67).

Public Service Commission has not developed adequate written procedures in the administrative areas of bookkeeping and property management.

Need for Improved Property Control (P. 70.)

Public Service Commission's property records have not been reconciled to the actual inventory of the agency.

Lack of Adequate Travel and Subsistence Procedures (P. 71)

Public Service Commission's travel procedures are not sufficient to ensure that public funds available for travel are utilized in accordance with State regulations.

Questionable Allowances for Meals (P.75)

Public Service Commission Law Enforcement Officers are claiming meal reimbursements which appear to be in violation of State regulations.

Questionable Subsistence for Commissioners (P.77)

The 1976-77 Appropriation Act allows Commissioners to receive subsistence regardless of their place of residence while State regulations prohibit the payment of subsistence to employees within 40 miles of their residence.

CONCLUSION

Prior to the early 1970's utility regulation had not assumed the vitally important role it has since that time. The rising cost of utilities is a serious and complex problem involving numerous politically sensitive issues. During the past five years the cost of electricity has increased rapidly and utility regulators in all states have become far more visible, and their activities far more important, to the consuming public.

While most utility regulators, including the South Carolina Public Service Commission, have taken positive steps to keep up with the increasing need for effective utility regulation, even in the most affluent states, utility costs are rapidly becoming a major public concern. With rate increases being the rule rather than the

exception, it is essential that utilities operate as efficiently as possible and that consumers have confidence in the regulatory process.

The current system for regulating electrical utilities in South Carolina was found to place consumers and the Public Service Commission in positions of inferiority with respect to utilities during the rate-making process. If rate-making is to be an equitable process in which all the parties are treated fairly, changes in the system must be made. The body of the report describes the system as it exists and makes a number of recommendations designed to improve it in such a way as to better serve the public interest.

INTRODUCTION

SCOPE

The Legislative Audit Council was created under Act 1136 of 1974, as amended by Act 157 of 1975. The Council consists of three public members, elected by the General Assembly to non-concurrent six year terms, and six ex officio members: The President of the Senate, the Speaker of the House of Representatives, the Chairman of the Senate Finance Committee, the Chairman of the House Ways and Means Committee, and the Chairmen of the Senate and House Judiciary Committees. The Council employs professional and clerical staff personnel who conduct audits under the supervision of the Council.

The Legislative Audit Council provides a number of services to the General Assembly of South Carolina. It conducts audits and investigations of State or State-related agencies and programs as referred to it by the General Assembly, Legislative Committees or Assembly Members, and generates a schedule of audits of the operations of State agencies and departments to be performed periodically.

This audit of the South Carolina Public Service Commission (PSC) was requested by a group of legislators who expressed a special interest in (1) rates charged by electrical utilities, (2) the methods used by the companies and PSC in determining rates, and (3) the fuel adjustment clause. In conducting this audit the Council staff emphasized the operations of those portions of the Public Service Commission directly related to the expressed interests of the requesters.

Despite the fact that PSC is a relatively small agency, evaluating its performance was a difficult task. Utility regulation is a highly complex and technical field and it was necessary for the Council staff to spend a significant period of time familiarizing itself with the mechanics of agency operations and the technological aspects of electrical generation and distribution as well as those aspects of utility accounting which differ from standard accounting practices.

The audit concentrated on PSC activities during FY 75-76; however, certain information concerning activities in previous years was collected and analyzed in order to present a more complete picture of the development and current status of the agency.

The Council staff performed an extensive analysis of agency documents, policies and activities as well as the statutes and regulations related to the operations of PSC. Numerous interviews were conducted with agency personnel and utility employees and relevant information was collected from several other State agencies. Documents concerning utilities published by the Federal Power Commission, Federal Energy Administration and other Federal agencies were analyzed. In addition, the staff examined two management studies performed by Cresap, McCormick and Paget, a private consulting firm retained by the General Assembly. (The most recent Cresap recommendations and the Council's evaluation of them can be found in Chapter V.)

A survey questionnaire designed to collect comparative data from other State utility regulation agencies was utilized. Forty-two (86%) of a possible forty-nine responses were received and analyzed and the resulting information was used in the Council's analysis of PSC's structure.

Council staff also examined such administrative areas as time and manpower allowed. These areas included administrative procedures, travel, property management and personnel records.

This report consists of five chapters. The first chapter includes descriptive information concerning PSC, electrical utilities in South Carolina and the concepts and problems addressed in the report. Chapter II consists of the findings and recommendations dealing with regulatory effectiveness, the independence of the Commission and the information it collects, and the protection of consumer interests.

Chapter III deals with PSC's activities in fuel adjustment clause design and monitoring and Chapter IV is composed of findings and recommendations concerning overall agency procedures and the efficiency of the agency itself. Chapter V addresses the recommendations made by Cresap, McCormick and Paget and includes the Council's evaluation and recommendations concerning that management study.

PURPOSE

The major purpose of this audit was to determine whether PSC provides the highest possible level of effective electrical utility regulation in the most efficient and economical manner possible. While these factors are important at all times, they are especially vital during periods of economic decline or uncertainty. The current economic situation demands tighter budgeting and the intelligent use of available funds, both by government and individuals. It is also necessary for government to provide high quality service to the people of the State. It is the Council's ultimate goal to assist the General Assembly in ensuring that these governmental priorities are met.

Electricity can be considered a necessity of life thus making the effective regulation of rates and service of major importance to the people. The Legislative Audit Council has examined electric utility regulation in South Carolina in full realization of its importance and hopes that its findings and recommendations will serve to increase regulatory effectiveness and efficiency.

THE NEED FOR APPROPRIATE CORRECTIVE ACTION

It is only recently that utilities and utility regulators have come under the widespread suspicion with which they are now regarded. Inflation, fluctuating and uncertain fuel prices, and other steadily rising costs have had their greatest impact on utilities during the past five or six years. Indeed, during the 1960's electricity prices generally decreased, and prior to that time utility regulators were much less active than they are today.

Where possible, the Council has attempted to make recommendations which call for little if any actual increase in the size or funding of the Public Service Commission. Every attempt should be made to utilize the resources already available within PSC and other State agencies more effectively. Changes that are necessary should not significantly increase the burden on the tax or rate payer. Where increased expenditures are recommended, the potential benefit to the public was the Council's guiding concern.

The Council wishes to express its appreciation to the members and staff of the South Carolina Public Service Commission for their assistance and cooperation during this audit. Much of this audit was conducted during a major rate case (Carolina Power & Light Company) thus enabling the Council to see PSC "in action". For the

most part, PSC seemed competent and dedicated to effective utility regulation. This report reflects that perception in that many of the Council's findings are systemic in nature.

CHAPTER I

BACKGROUND: UTILITIES AND UTILITY REGULATION

INTRODUCTION

This chapter is designed to acquaint the reader with general information concerning public utility regulation in South Carolina. The first section consists of a discussion of the nature of utilities and utility regulation. The second traces the history and organization of PSC. Section three deals with agency funding and includes a table of agency appropriations since FY 71-72. The fourth section provides some selected statistical data concerning electric utilities in South Carolina.

THE NATURE OF PUBLIC UTILITIES AND UTILITY REGULATION

Utilities

A public utility can be defined, in general terms, as an entity which provides an essential service to the public and whose activities in providing that service are regulated. In many countries of the world direct government ownership and operation of public utilities provides direct regulation; however, in the United States, most utilities are either privately-owned, investor-owned or cooperative (owned by the persons served by the utility). Of course, there are exceptions, the most notable being the Tennessee Valley Authority and a large number of municipally-owned utilities. The South Carolina Public Service Authority is another exception. This report focuses on privately-owned electric utilities.

Public Utilities Provide Essential Services

There are several important characteristics of public utilities,

First, as stated in the definition above, public utilities provide essential services for which there is a public necessity and/or demand. The absence of these services would work a severe hardship on the public and these services are among the last to be sacrificed during periods of economic difficulty. In fact, these services are generally considered so essential that rapid and severe price increases do not substantially alter the demand for them.

Public Utilities are Monopolistic

Public utilities are monopolistic. Competition among utilities during their formative period resulted in duplication among neighboring utilities, inefficient use of utility resources, high costs and inadequate service. Currently, utilities are assigned service areas in which they are the sole provider. Customers residing in these service areas are required to deal with the utilities operating there and are not able to "shop around" for the lowest price or best service.

Public Utilities are Capital Intensive

Public utilities tend to be capital intensive in that they expend large sums of money in the physical plant used to provide service. In the case of electrical utilities this means that substantial amounts of money are spent on generating plants, distribution and transmission facilities and other fixed assets. The capital intensive nature of utilities generally obligates them to attract large amounts of investment capital in order to remain viable, and it is the cost of acquiring these large sums of capital investment that is one of the major factors in the price of the service provided.

Rights and Performance Standards

Regulators of public utilities generally grant certain rights or advantages to the utility while demanding certain performance standards in return. Utilities are protected from competition. In most cases the company is the sole provider of services to the persons residing in its service area. In addition, utilities are allowed to earn a "reasonable" profit for providing service.

In return, utility companies are required to provide safe and adequate service on an equal basis to any potential customer in their service areas. Companies may not discriminate on a personal basis (race, religion, etc.) or on a locational basis (urban, rural), and service must fulfill the present needs of the public and be prepared to meet future demands.

Utility Regulation

In the United States, the authority to regulate public utilities is vested, for the most part, in State and Federal regulatory commissions. While they are called by various names (e.g., Public Service Commission, Public Utilities Commission, Railroad Commission, Corporation Commission, etc.), and have differing levels of jurisdiction (e.g., private, private and cooperative, transportation, etc.), they perform essentially the same functions: the regulation of rates, facilities construction, service areas, and commencement and termination of service, among others.

Regulatory commissions have been in existence about one hundred years. Prior to that time utility regulation was carried out by the Legislature, through the courts on a case by case basis, or by local governments (as is still the case in some areas).

At the Federal level utility regulation began with the Interstate Commerce Commission (1887) and saw its greatest period of growth during and after the 1930's with the establishment of such agencies as the Federal Power Commission (electric and natural gas), the Federal Communications Commission (telephone, telegraph, radio and television) and two transportation related regulators, the Civil Aeronautics Board and the Federal Maritime Commission (air and water carriers).

The authority to regulate utilities stems from two major sources. At the Federal level, the commerce clause of the Constitution (Article 1, Section 8) authorizes the Federal government to regulate interstate commerce. In addition, various Supreme Court decisions have broadened Federal powers by interpretation. At the State level the power to protect the citizenry (police power) has been broadly interpreted to include public welfare.

In addition to constitutional authority regulatory bodies function under a wide variety of State and Federal statutes and regulations. In South Carolina, Sections 24-1 through 176, 58-1 through 17, 51 through 63, 101 through 155, 201 through 495, 651 through 1275, 1401 through 1661, 1691 through 1695 and 1801 through 1832 of the South Carolina Code provide the statutory basis for the Public Service Commission.

Regulatory Functions

Regulatory bodies such as the South Carolina Public Service Commission perform three major functions: policy-making, decision-making, and enforcement and administration. Policy-making includes making policy for the agency itself (internal) and for the utilities it regulates (external). Internal policies describe the goals and

objectives of the agency, rules and regulations utilized by the agency and criteria or standards which the agency must meet. Internal policies are often accompanied by formal or informal procedures for fulfilling them. In many cases the activities (practices) which must be performed are also included. External policies provide the same direction and guidance for regulated utilities. In most cases, however, the utility itself formulates the procedures and practices it will use to ensure adequate performance. Using government as a model, policy-making can best be described as legislative in nature.

Decision-making is usually the most visible, and most publicized of regulatory agency functions. It is a judicial or quasi-judicial function in that it is usually characterized by an adversary proceeding between a utility requesting rate relief and parties protesting the request. The regulatory agency functions as judge and jury in such proceedings by ruling on procedures and actions during the rate case and deciding the case based on the evidence and information presented. In addition, Commission decisions can usually be appealed to the judicial system. Thus, the Commission is required to ensure that cases are handled properly and that decision-making is conducted in a manner appropriate to judicial matters. In South Carolina most cases are heard by the full Commission though in some instances, usually cases involving smaller utilities under crowded docket conditions, fewer Commissioners may preside. In this State also, the rules and procedures for the case itself are less formal concerning protestors, thus allowing them more leeway in their testimony and questioning.

The third major function of regulatory agencies is enforcement and administration. It can be likened to the executive functions of

government and consists of such activities as enforcing motor transportation and utility safety regulations, issuing licenses and processing the various forms required by the agency.

These three major functions provide the overall framework in which specific activities and goals can be placed. Among them are rate-making, consumer representation, safety inspection, environmental protection, liaison with other regulatory agencies, licensing, resource conservation, etc. When viewed within this framework, regulatory commissions can be seen as more than decision-making bodies. Indeed, their impact goes well beyond the results of a rate case. However, it is the impact of the rate case that is felt most by the consuming public and no discussion of the nature of utilities and utility regulation would be complete without addressing that vital area. (See Chapter II).

HISTORY AND ORGANIZATION OF THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION⁽¹⁾

The two major divisions of the present day South Carolina Public Service Commission, the Utilities Division and the Transportation Division, developed from separate regulatory bodies established by the General Assembly.

In 1878, the Legislature created the Railroad Commission to supervise and regulate the operation of railroads in the State. This mandate, with the addition of jurisdiction over other types of for hire motor carriers, is currently the legislative basis for the Transportation Division.

(1) Sources: PSC, 97th Annual Report, 1974-75; Agency Interviews; S.C. Code of Laws; South Carolina Legislative Manual.

Water, gas and electric utilities came under the jurisdiction of a Public Service Commission created by the General Assembly in 1910. With the addition of telephone, telegraph, radio common carrier and sewerage facilities, this "Commission" now comprises the Utilities Division.

The General Assembly combined these two Commissions in 1922. One Commissioner was added to the three Railroad Commissioners and three Public Service Commissioners for a total of seven. In 1934, Public Service Commission became the official name of this regulatory body.

The seven Public Service Commissioners are elected by the General Assembly to four-year terms. The seven Public Service Commission districts are "...defined as, and constituted, as congressional districts on January 1, 1930...) (Code 58-52). The current composition of the Commission is as follows:

1st District (Berkeley, Charleston, Clarendon, Colleton and
Dorchester Counties) - Julian F. Leamond (Term
expires 1979).

2nd District (Aiken, Allendale, Bamberg, Barnwell, Beaufort,
Edgefield, Hampton, Jasper, Saluda) - Rudolph
Mitchell (1978).

3rd District (Abbeville, Anderson, Greenwood, McCormick,
Newberry, Oconee, Pickens) - Guy Butler, Chairman
(1979).

4th District (Greenville, Laurens, Spartanburg, Union) -
Fred A. Fuller, Jr., Vice-Chairman (1979).

5th District (Cherokee, Chester, Chesterfield, Fairfield,
Kershaw, Lancaster, York) - J. Lewis Moss (1979).

6th District (Darlington, Dillon, Florence, Georgetown,
Horry, Marion, Marlboro, Williamsburg) -
J. Henry Stuckey (1978).

7th District (Calhoun, Lee, Lexington, Orangeburg, Richland,
Sumter) - Henry G. Yonce (1979).

The Commissioners have served, at this time (1976), terms as follows: LeMond (appointed February, 1977), Mitchell - 3 years, Butler - 13 years, Fuller - 7 years, Moss - 23 years, Stuckey - 6 years, and Yonce - 5 years.

Administration

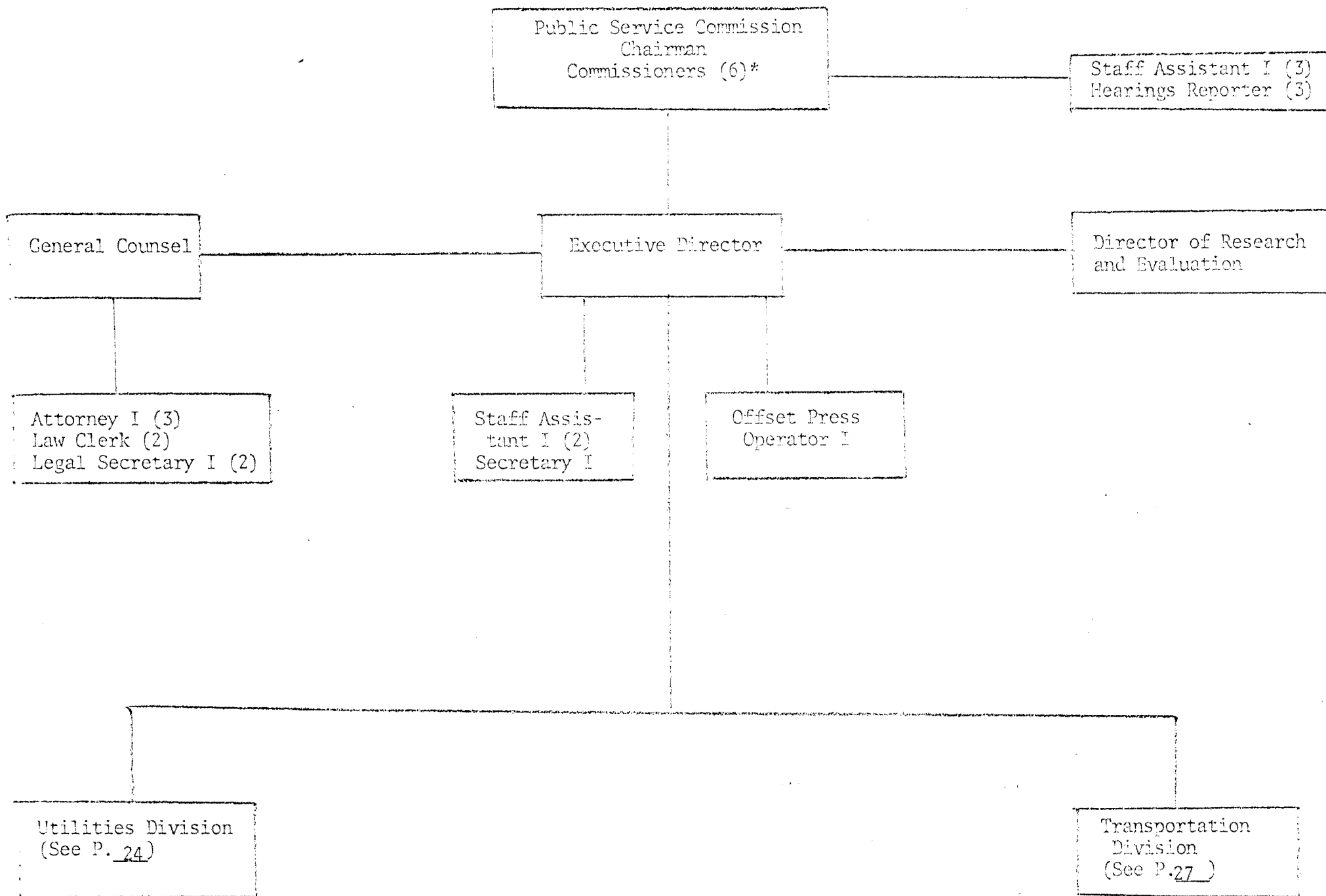
The Administration Division provides overall administrative support to the Commissioners and supervises the activities of the Utilities and Transportation Divisions. The Division includes an executive director⁽²⁾ who serves as chief staff officer of the Commission and is thus responsible for providing staff leadership in formulating and implementing agency policy, preparing, directing and monitoring agency activities, and such other activities as are required by the Commission. He also serves as the liaison between the staff and the Commissioners.

The Administration Division also provides legal assistance to the Commissioners in the form of a General Counsel assigned by the Attorney General, additional legal and clerical staff, and court reporters who are responsible for transcribing the testimony given in rate hearings.

Currently, the Administration Division receives \$430,074.00 for overall agency administration.

(2) Formerly Director of Administrative Services.

Public Service Commission



* = Number of such personnel, if more than one.

Utilities Division

The Utilities Division is divided into six departments; administration, accounting, electric, gas, telephone and telegraph, and water and sewerage. The Administration Department plans and supervises the activities of the other five departments and provides administrative and other services as required by the departments, the executive director or the commissioners.

The Accounting Department audits utility companies prior to their appearance before the Commission in rate proceedings and performs the accounting duties for the Division. In addition, this department conducts periodic compliance audits to ascertain whether utilities are utilizing proper accounting procedures, and performs special audits (such as fuel adjustment clause audits) when required. The department also maintains statistical data and furnishes it to State and Federal agencies and other interested parties.

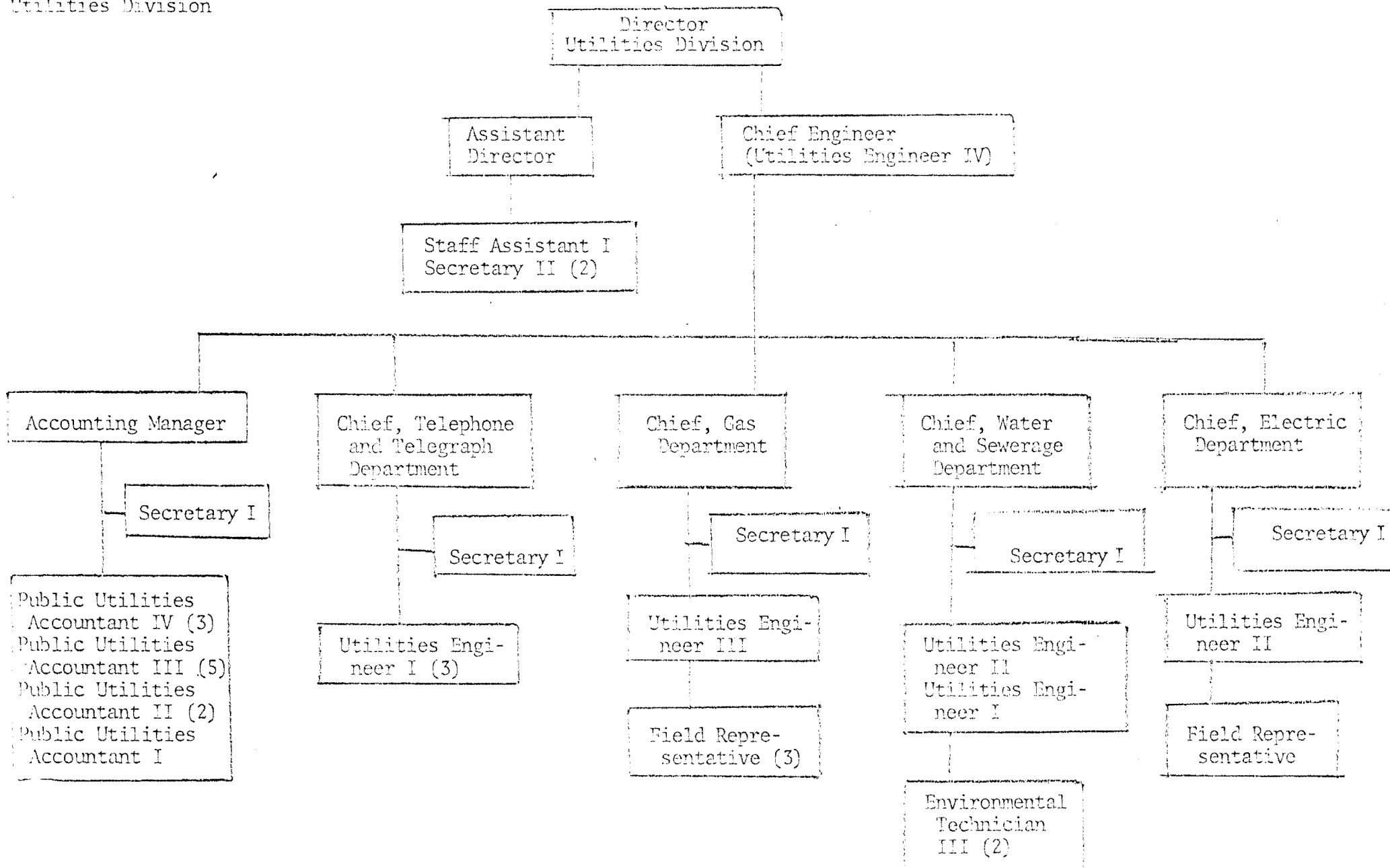
The Electric, Gas, Telephone and Telegraph, and Water and Sewerage Departments perform similar functions in their respective areas. They handle consumer complaints concerning service or billing, maintain test equipment and perform safety and service tests as necessary and prepare information, mostly in the area of engineering, for use in rate cases.

In addition, the Electric Department is responsible for staff support in enforcement of the "Utility Facility Siting and Environmental Protection Act," the Gas Department enforces the State and Federal gas pipeline safety acts, the Telephone and Telegraph Department is responsible for regulating radio common carriers, and the Water and Sewerage Department is responsible for staff support in

granting Certificates of Public Convenience and Necessity. Each department is also involved with setting up service territories.

For Fiscal Year 1977, the Utilities Division received \$761,855.00 for the following functions: Administration - \$242,555.00, Accounting - \$184,430.00, Telephone - \$72,194.00, Gas - \$90,235.00, Water and Sewer - \$83,361.00 and Electric - \$89,680.00.

Utilities Division



Transportation Division

The Transportation Division is divided into five departments; Administration, Law Enforcement and Safety, Licensing, Rails and Tariffs, and Registration.⁽³⁾

The Administration Department is responsible for planning and supervising the activities of the other four departments. In addition, it provides the Division with an accounting and auditing capability. These accountants audit motor carriers and railroads to determine whether proper accounting procedures are being utilized and whether expenditure levels are responsible. They also examine such other areas as directed.

The Law Enforcement and Safety Department enforces the State Motor Vehicle Carrier Law and the U. S. Department of Transportation Safety Rules and regulations. Its responsibilities include motor carrier inspections, accident investigations, and ensuring that hazardous material are transported correctly.

The Licensing Department processes applications for motor carrier licenses and issues license plates. It also ensures that motor carriers are properly insured, that the proper rates are on file, and that other motor carrier activities are in compliance with law.

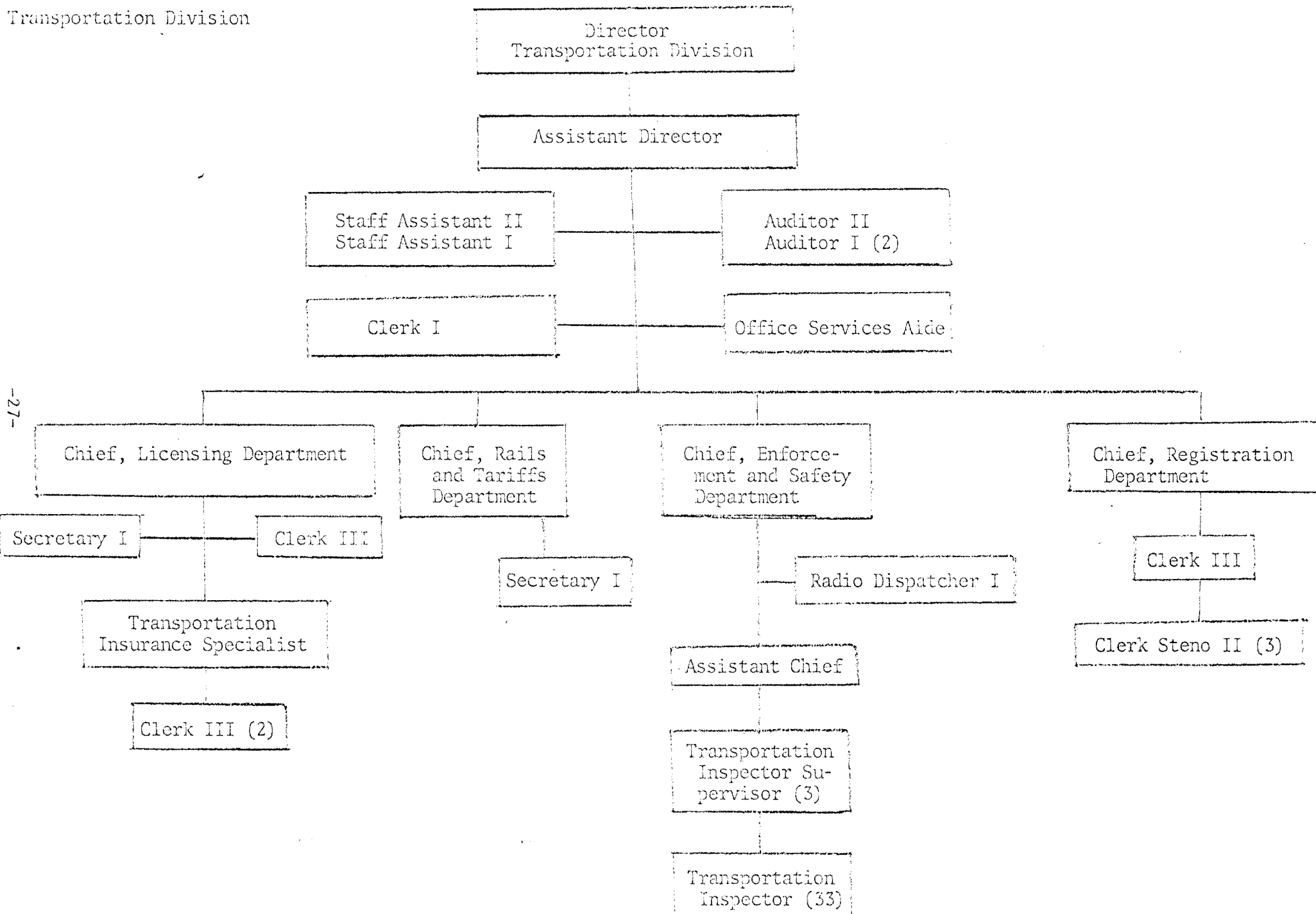
The Rails and Tariffs Department is responsible for examining and analyzing all proposed rate changes and advising the Commission during rate cases. The Department also conducts rail safety investigations and inspections, and coordinates disaster and defense readiness activities for the Commission.

⁽³⁾ Formerly Registration and Safety.

The Registration Department is responsible for registering certified and exempt commodity interstate motor carriers. Registration fees are charged and identification stamps for motor carriers operating into or through the State are sold. Field enforcement is the responsibility of the Law Enforcement and Safety Department.

The Transportation Division received \$752,798.00 for the following functions: Administration - \$228,485.00, Licensing - \$53,377.00, Rates - \$47,812.00, Law Enforcement - \$423,124.00.

Transportation Division



FUNDING

The Public Service Commission receives no tax based appropriation from the General Assembly. The General Assembly appropriates the funds to be received by the Commission, but these funds are collected from utilities regulated by the Commission rather than taxpayers. After the Appropriation Act is passed, and the assessments set by that Act, the funds are collected by the treasurers in the counties in which the principal offices of the regulated companies are located.

The Administration and Utilities Divisions are funded through assessments on electric, gas, telephone, telegraph, water, sewerage, radio common carrier and rail companies. These assessments are based on the gross revenue of the company.

Transportation Division funds are collected through license fees. Excess funds are deposited with the State Treasurer and subsequently distributed to municipalities in the State.

The following table (Figure 1) illustrates State appropriations for, and staffing of the Public Service Commission since FY 72. Included in the table are appropriations for each year from FY 72 - FY 77, for the agency as a whole and selected portions of it. Yearly and overall increases are stated as percentages. Also included are the number of classified positions and amount of personal services (salaries) granted through legislative appropriations and yearly and overall percentage increases. The last line indicates the proportion of the overall budget utilized for personal services.

Figure 1 - Public Service Commission Appropriations, 6 Year Period⁽¹⁾

Fiscal Year Budget Item	Dollar Amount / Percentage Increase Over Previous Year						Total Percentage Increase FY 72-77
	FY 1972 (7/1/71-6/30/72)	FY 1973 (7/1/72-6/30/73)	FY 1974 (7/1/72-6/30/74)	FY 1975 (7/1/74-6/30/75)	FY 1976 (7/1/75-6/30/76)	FY 1977 (7/1/76-6/30/77)	
I. Commissioners	(2)	(2)	(2)	262,941 / -	277,496 / 05.6%	297,197 / 07.1%	13.0% ⁽⁷⁾
II. Administration	(2)	(2)	(2)	292,845 / -	333,992 / 65.4%	430,074 / 28.8%	113.1% ⁽⁷⁾
Total Admin. (I & II)	263,422 / -	348,610 / 32.3%	415,991 / 19.3%	464,786 / 11.7%	611,398 / 31.5%	727,271 / 19.0%	176.1%
III. Utilities							
A. Admin.	62,964 / -	86,875 / 40.0%	132,468 / 52.5%	157,974 / 19.3%	221,473 / 40.2%	242,555 / 09.5%	285.2%
B. Accounting	59,489 / -	83,275 / 37.8%	83,975 / 00.8%	101,669 / 21.1%	148,016 / 45.6%	184,430 / 24.6%	210.0%
C. Telephone	26,462 / -	29,987 / 13.3%	43,337 / 89.8%	49,205 / 13.5%	64,772 / 35.7%	72,194 / 08.1%	172.5%
D. Gas	53,157 / -	56,909 / 07.1%	58,999 / 07.1%	64,498 / 09.5%	68,031 / 05.5%	90,235 / 32.6%	69.5%
E. Water and Sewerage	14,500 / -	26,187 / 80.6%	43,637 / 66.6%	49,760 / 14.0%	74,994 / 50.7%	83,361 / 11.2%	474.9%
F. Electric	46,472 / -	45,212 / -2.7%	45,862 / 01.7%	49,574 / 07.9%	64,900 / 39.9%	89,080 / 37.3%	91.7%
Total Utilities	263,044 / -	329,445 / 24.9%	408,293 / 24.3%	472,680 / 15.8%	644,186 / 36.3%	761,955 / 18.3%	189.6%
IV. Transportation	354,744 / -	383,747 / 08.2%	635,802 / 65.7%	581,052 / -8.6%	671,447 / 15.6%	752,798 / 12.1%	112.2%
Total P.S.C.	881,210 / -	1,060,802 / 20.4%	1,537,407 / 44.9% ⁽⁴⁾	1,561,631 / 01.6% ⁽³⁾	1,927,031 / 23.4%	2,241,924 / 16.3%	154.4%
Number of Classi- fied Positions ⁽⁵⁾	74	89	96	91	103	113	52.7%
Total Personal Services ⁽⁶⁾	688,914 / -	802,783 / 16.5%	881,851 / 09.8%	1,025,890 / 16.3%	1,272,033 / 24.0%	1,440,326 / 13.2%	109.0%
Personal Services as a Percentage of Total Approp.	78.2%	75.7%	57.4%	65.7%	66.0%	64.2%	N/A

(1) Sources: State Appropriations Acts and Budget Documents.

(2) Commissioners and Administration combined in Appropriations Act prior to Fiscal Year 1974-75 (See Total Admin.).

(3) Includes Base Pay Increases of \$43,107.

(4) Includes Compensation Increases of \$77,326.

(5) Includes Commissioners and Full and Part-time Classified Positions as specified in Appropriations Act.

(6) For Positions Above - Dollar Amount / Percentage Increase Over Previous Year.

(7) FY 75-77 only.

Several observations can be made based on the information contained in the table:

- (1) Administration is a substantial part of the cost of utility regulation and administrative appropriations have been increased more than other appropriations during this period. A substantial portion of these increases, especially in FY 76, were due to increased legal staffing and the termination of free telephone service. (Water and Sewerage Department's overall increase of 474.9% is due, in great part, to an extremely low base at the beginning of the period analyzed) during this period.
- (2) Of the three departments involved with areas of great public concern (electricity, gas and telephone) only the Telephone Department increase approaches that of the Utilities Division total or exceeds the overall increase for PSC. Increases for both the electric and gas departments are well below the agency average.
- (3) The Accounting Department, which provides rate case auditing and other services to other departments, received an overall increase substantially larger than the agency or Utilities Division averages, yet

even if that increase is pro-rated among the departments served, no department can equal administrative increases.

Conclusion and Comment

While there are many reasons for funding increases and not all increases can be tied to any one functional area, it is obvious that funding increases have tended to be in administration rather than technical, engineering and accounting areas. In those cases where increased legal assistance was necessary the additional funding seemed warranted. However, regulatory effectiveness and public confidence would be better served if funding priorities were closely examined to determine whether administrative increases of the magnitude experienced since FY 72 are appropriate to the agency's goals, or whether increases in the technical, engineering and accounting areas might better serve the public interest.

ELECTRIC UTILITIES IN SOUTH CAROLINA

As stated in the introduction, this audit was designed to examine the effectiveness of PSC in regulating electric utilities with emphasis on rate-making and the Fuel Adjustment Clause. The Commission regulates three major electric utilities: South Carolina Electric and Gas Company (SCE&G), Duke Power Company (Charlotte, N. C.) and Carolina Power and Light Company (CP&L, Raleigh, N. C.). The table below gives some basic information concerning these companies.⁽⁴⁾

⁽⁴⁾Source - PSC Annual Report (75-76, Draft).

<u>Company</u>	<u>Number of Residential Customers, 1975</u>	<u>(% of Total)</u>	<u>KWH Sold (Res.), 1975</u>	<u>(% of Total)</u>
SCE&G	263,711	(43.4%)	2,893,003,110	(42.6%)
Duke	251,187	(41.4%)	2,824,847,000	(41.6%)
CP&L	<u>92,596</u>	<u>(15.2%)</u>	<u>1,072,863,827</u>	<u>(15.8%)</u>
TOTAL	607,494	(100.0%)	6,790,713,937	(100.0%)

SCE&G's service area encompasses 24 counties in the central, southeastern and southwestern parts of the State, Duke Power serves much of the northwest and CP&L the northeast. South Carolina is also served by three other privately-owned companies, 22 rural electric cooperatives and 21 municipally-owned utilities.

SCE&G, Duke Power and CP&L use four major types of electricity producing plants: fossil fuel steam generation plants, internal combustion turbine plants, nuclear steam generation plants and hydroelectric plants. The table shows generating capacity by type of plant in kilowatts.

	SCE&G	DUKE POWER	CP&L
Fossil Steam	2,536,000 (82%)	454,700 (10%)	203,635 (13%)
Internal Comb.	282,000 (09%)	326,000 (07%)	646,320 (40%)
Nuclear	- -	2,598,000 (58%)	768,681 (47%)
Hydro	<u>264,860 (09%)</u>	<u>1,088,075 (25%)</u>	<u>--</u>
TOTAL	3,082,860 (100%)	4,466,775 (100%)	1,618,636 (100%)

Several observations can be made from the table:

- (1) Duke generates more than four-fifths of its electricity using nuclear and hydroelectric plants rather than more expensive fossil fuel plants.⁽⁵⁾
- (2) Almost half of CP&L's generation is from nuclear plants rather than fossil fuel plants.
- (3) SCE&G generates 91% of its power using fossil fuel; however, the expected addition of a 900,000 KW nuclear unit in 1979 will reduce fossil fuel generation to an estimated 65%. This will still be a much higher rate of fossil fuel generation than either Duke or CP&L.

The proportions listed above represent the "generation mix". This "generation mix" has an effect on the cost of electric power to the consumer. Other factors in the price of electricity include fuel cost, cost of construction, size and efficiency of generating plant, proximity to fuel sources, transmission and distribution efficiency, and administration and operating costs.

(5) While construction and some operating costs of nuclear plants are high, the current fuel cost is lower than fossil fuel. The safety of nuclear plants, an extremely controversial subject, is not treated in this analysis.

CHAPTER II

UTILITY RATE-MAKING IN SOUTH CAROLINA

As discussed earlier in this report, it is the quasi-judicial decision-making process which is one of the most important and most visible functions of regulatory bodies. In the Public Service Commission, this process establishes the rates to be paid by consumers and is generally the focus of agency activities.

In compiling the information for this chapter, the Legislative Audit Council analyzed the rate-making process using two recent cases involving electrical utilities (South Carolina Electric and Gas Company and Carolina Power and Light Company). In addition, the Council surveyed other State regulatory bodies and gathered information from other governmental and evaluative organizations. Numerous interviews were conducted with agency, utility and governmental personnel and extensive document analysis was performed.

As a result, the Council was able to identify major weaknesses in the rate-making process. These weaknesses and recommendations for improvement are discussed in the remainder of this chapter.

SUMMARY OF FINDINGS

1. Need for Increased Emphasis on Utility Efficiency in Rate-making.

The Public Service Commission is unable to independently determine the level of efficiency in utility companies and the current philosophy of the Commission does not emphasize the importance of such analysis.

This approach tends to cause utility regulation to drift

away from its central purpose of ensuring efficient utility operation and the lowest possible price for electrical service.

2. Lack of Independent and Objective Information for Decision-making

The majority of information used by the Public Service Commission for rate-making purposes is supplied directly by the utilities themselves. While much of this data is verified through auditors, some could be biased and interpreted by the company to best support its position. A higher level of confidence could be achieved if Public Service Commission developed information necessary for rate decisions independently whenever possible.

3. Inadequate Legal Representation of Consumers

The average consumer is not provided adequate legal representation in Public Service Commission rate proceedings. Utility companies are able to retain legal expertise and expert testimony while the public of South Carolina is not provided comparable assistance and representation.

4. Lack of Information Concerning Consumer Interest and Commission Activities

The Public Service Commission does not collect adequate information concerning the needs of the consuming public. In addition, the public is not adequately informed as to the activities and regulatory priorities of the Commission.

INTRODUCTION

Regulation of public utilities is a highly complex, technical and time consuming process. Rate-making requires a great deal of expertise, special knowledge, and detailed examination of voluminous data. At the same time, it is not an exact science, but rather something of an inexact art requiring the development of informed opinions, the exercise of discretion and good judgment. Despite the development and evolution of various formulas and other regulatory yardsticks for measuring and evaluating proposed adjustments in rates, there are no hard and fast solutions or clear answers to the various problems and questions involved in rate proceedings. As a consequence, some degree of conflict is inevitable in the rate-making process. Even when the experts agree on the factual data, they frequently will disagree on how the data should be interpreted and applied. Thus, rate-making is a subjective process involving judgments based on the facts presented by the parties to a rate case.

A great deal of cost, engineering, financial, economic, and other data must be analyzed and interpreted during a rate proceeding and various areas of specialization and expertise must be utilized to conduct the analysis accurately and effectively. Thus, all participating parties must bring to the process skill and understanding in all of these areas if they are to discharge their functions responsibly.

Decisions are made in a quasi-judicial manner. Due to the conflicts which are inherent in rate-making, and due to the need to identify

the most significant facts from among masses of data, volumes of expert testimony, and a wide variety of opinions and interpretations, rate-making is almost inevitably an adversary proceeding. Generally, the opponent on one side (the initiator of the action) is the utility company seeking an increase in rates. In theory, the customers are the opponents on the other side. However, due to their fragmentation, dispersion, and diversity of interests, the customers are seldom in a position to undertake effective and unified action on their own behalf. Only some of them may have the desire and capability to oppose the utility directly, while most must rely upon the government to act as their representative and defender.

NEED FOR INCREASED EMPHASIS ON UTILITY EFFICIENCY IN RATE-MAKING

The current regulatory approach of the Public Service Commission does not include adequate examination of the efficiency of utility companies, though such activities are authorized by Statute (S.C. Code 24-113).

Review of the SCE&G rate case (1975) and CP&L rate case (1976), revealed that the Public Service Commission used a cost plus profit method for determining the size of the rate increase granted. Its decision was based on analysis of four major factors:

- (1) Rate Base - the assets or investments utilized to provide services, including physical plant and working capital.
- (2) Rate of Return - the income that should be earned on the rate base.
- (3) Operating Costs - amount expended for operating expenses as compared to company revenues.

- (4) Rate Increase - amount of additional revenue necessary to provide adequate profits over and above costs and investments.

While information concerning "plant" efficiency was collected and analyzed, little attempt has been made by the Commission to analyze the overall efficiency of utilities. The Council's examination of PSC activities and interviews with Commissioners indicate that the Commission does not consider the analysis of efficiency among their regulatory priorities.

In 1944 the Supreme Court discarded the cost plus profit method in favor of a "just and reasonable effect" philosophy which is more conducive to rate-making based on efficiency factors including price and quality (Federal Power Commission, et al. v. Hope Natural Gas Company, 320 U. S. 591). This decision stated that a Federal Power Commission (FPC) rate order was valid because the impact or total effect of the order was just and reasonable. The method of computing the rate base was not considered a factor even though it might result in a "meager return on a rate base computed on the 'present fair value' method." This means that a regulatory body such as PSC may use any method necessary in order to effectively serve the public interest.

The Council found that the method used by PSC requires such a heavy concentration on the narrow issue of costs and profits to the utility that it provides too little time for the Commission to pay sufficient attention to the question of efficiency in the operation of the utility.

Regulatory effectiveness in South Carolina could be enhanced by the examination of the efficiency of utility operations. The ability of the Commission to determine the worthiness of utility requests would be strengthened by the use of periodic operational review for efficiency and the use of industry standards. While efficiency studies have been used by the Commission, these studies were not done by a firm selected or supervised by the Commission. The independence and objectivity of such data would be better ensured by direct Commission control of the study. (See also pp. 40-43).

Further, through the use of such analytical tools as econometric models, the Commission could better analyze requests for capital expansion. The Commission would then be able to reward utilities for efficiency and penalize them for inefficiency through the rate-making process.

Such activities by the Public Service Commission directed toward decreasing utility costs and ensuring optimum efficiency are appropriate and acceptable for any agency charged with the responsibility of protecting the best interests of the citizens of the State.

RECOMMENDATIONS

- (1) PSC SHOULD DEVELOP A SYSTEM FOR MONITORING THE EFFICIENCY OF UTILITY COMPANIES. THIS SYSTEM SHOULD STRESS THE SIMULATION OF COMPETITIVE MARKET CONDITIONS AND ENSURE THAT UTILITY REGULATION IS FOCUSED ON PRICE AND QUALITY OF SERVICE.

- (2) PSC SHOULD COLLECT AND ANALYZE ACCURATE AND OBJECTIVE INFORMATION CONCERNING THE EFFICIENCY OF UTILITY COMPANIES. RATE RELIEF SHOULD NOT BE GRANTED IF A COMPANY DOES NOT ACHIEVE EFFICIENCY STANDARDS EXPECTED OF COMPANIES IN FREE MARKET SITUATIONS.
- (3) PSC SHOULD REQUIRE UTILITIES TO DEVELOP GOALS AND OBJECTIVES TO BE ACHIEVED BOTH IN THE SHORT-RUN AND THE LONG-RUN. THESE GOALS AND OBJECTIVES SHOULD INCLUDE OPERATIONAL ACTIVITIES (e.g., TECHNOLOGICAL CHANGES), AND SERVICE (e.g., PRICE AND QUALITY).
- (4) PSC SHOULD REQUIRE UTILITIES TO JUSTIFY ALL MAJOR CAPITAL EXPENDITURES ON A COST-BENEFIT BASIS DIRECTLY RELATED TO PRICE AND QUALITY OF SERVICE.
- (5) PSC SHOULD SEEK TO DEVISE NEW REGULATORY FORMULAS WHICH WILL PROVIDE INCENTIVES FOR UTILITY COMPANIES TO ACHIEVE MAXIMUM EFFICIENCY AND ECONOMY OF OPERATION, WHILE MAINTAINING SUITABLE STANDARDS OF SERVICE.

LACK OF INDEPENDENT AND OBJECTIVE INFORMATION FOR RATE DECISION-
MAKING.

The Legislative Audit Council's review of PSC operations found that the majority of information upon which rate case decisions are based is supplied directly by the utility company requesting the rate increase. Included among this information is:

- The cost of providing electrical service.
- The earnings position of the utility.
- Revenues, sales, and customers.
- Expenses, taxes, and depreciation.
- The company's rate base.
- Net revenues of the company.
- Financial requirements of the utility.
- Capitalization (debt versus equity financing).
- The cost of money.

This situation appears to result from the inability of the Public Service Commission to generate and collect this information itself. PSC staff currently verifies the accuracy of much of the data through audit procedures but this staff has neither the time nor the resources to fully examine the content and interpretation of all company data, much less to generate independent data. Thus, PSC relies on utility companies, with their vast resources, to provide the majority of data upon which their rate requests are judged.

For example, the Commission uses cost of service studies as a major information source for determining the amounts to be granted in the various rate categories (residential, commercial, industrial, etc.)

Despite the generally high quality of the Commission's verification and audit procedures, some types of information (such as cost of service studies, depreciation studies and other such data) can be interpreted in such a way as to support one side of the case, or another.

If the public interest is to be truly served, it is essential that all information upon which rate cases are decided be as objective as possible. Objectivity of interpretation is also of great importance because, in the final analysis, rate decisions are based on the interpretation of data.

In addition, and perhaps of greater importance, is the impact of company generated data on the ability of the consumer to oppose rate increases. Utility companies have the resources to generate massive amounts of complex data to support their cases while the average citizen is hard-pressed to understand company data much less generate opposing information.

The importance of independent information is further reinforced by a study of regulatory effectiveness recently completed by the Oversight Subcommittee of the Commerce Committee of the United States House of Representatives. Evaluation of nine Federal regulatory agencies indicated that the Federal Power Commission's effectiveness was the lowest of the group. One of the reasons for this low rating was the FPC's reliance on data submitted by the companies it regulates.

It must be emphasized that the utility supplied data upon which rate decisions are based is paid for by consumers when they pay electric bills. Since the consumer will pay whether the information is supplied by the utility or generated by the Public Service Commission, it is logical to assume that the public interest is best served if information is generated in such a way as to ensure greater objectivity.

Nationwide data and examination of the recent SCE&G and CP&L rate cases indicate that companies almost always receive rate increases approximating their requests. In effect, the rate case procedure, with its reliance on company generated information, does not guarantee due process to consumers, nor does it ensure that decisions are in the public interest.

RECOMMENDATION

INFORMATION REQUIRED BY THE PUBLIC SERVICE COMMISSION SHOULD BE COLLECTED AND GENERATED BY THE COMMISSION STAFF OR BY AN INDEPENDENT PARTY HIRED AND SUPERVISED DIRECTLY BY THE PUBLIC SERVICE COMMISSION. PSC SHOULD ENSURE THAT THE TASK IS CARRIED OUT IN THE MOST ECONOMICAL MANNER POSSIBLE. ANY STAFF INCREASES NECESSITATED BY THIS ADDITIONAL RESPONSIBILITY SHOULD BE WEIGHED AGAINST THE ECONOMIC ADVANTAGE OF UTILIZING INDEPENDENT PARTIES AND ANY EXPENDITURES SHOULD BE FULLY JUSTIFIED TO THE GENERAL ASSEMBLY.

INADEQUATE LEGAL REPRESENTATION OF CONSUMERS

The Legislative Audit Council's examination of recent rate case proceedings indicates that consumers currently face a difficult task when they oppose rate increases. Utility companies, represented by attorneys who are experts in utility law, present

volumes of testimony and exhibits prepared by the companies to support their requests, and further support their cases with reports and testimony from consultants and expert witnesses.

Facing this barrage of highly technical information and expensive legal expertise is the consumer who is usually unable to understand the complexity of the rate case much less to marshal the resources necessary to effectively oppose the utilities' request.

The Public Service Commission's General Counsel and other staff attempt to determine the accuracy of data presented by utilities at rate hearings. However, our review indicated the staff does not have the resources available to the utilities. In addition, PSC staff is not mandated to function as a consumer advocate.

In South Carolina, the Attorney General's Office is required to "represent and appear for the people of the State and the Commission in all actions and proceedings involving any question of general and public interest within the jurisdiction of the Commission" (S. C. Code 58-62). In the past, members of the Attorney General's staff have appeared for consumers in a number of rate cases involving larger utility companies; however, there is no staff attorney available for rate case purposes on a full-time basis. Other responsibilities within the Office preclude an assignment of this nature. In addition, the Assistant Attorney General assigned to represent consumers in rate cases is usually inexperienced in utility law as compared to the company's attorney.

The importance of adequate public representation cannot be overemphasized. While many PSC procedures allow considerable leeway for consumers testifying during rate cases, trained legal assistance would greatly improve the comprehensiveness and impact of public statements. Legal research, effective cross-examination and a thorough knowledge of judicial decision-making (processes and precedents) are beyond the scope of most citizens. The absence of adequate legal representation does not ensure due process for rate protestors. In proceedings with such a high level of impact on the citizens of the State, the consumer should be as well represented as utility companies. The lack of effective opposition could result in rate decisions based on one side of the argument.

RECOMMENDATION

THE GENERAL ASSEMBLY, IN CONSULTATION WITH PSC AND THE ATTORNEY GENERAL, SHOULD DEVISE AND MANDATE A SYSTEM THAT WOULD ENSURE THAT CONSUMERS ARE REPRESENTED AT A LEVEL EQUAL TO UTILITY COMPANIES DURING RATE CASES AND OTHER PROCEEDINGS HAVING IMPACT UPON THE PUBLIC.

ONE POSSIBLE SOLUTION WOULD BE TO PASS LEGISLATION MANDATING THE CREATION OF A CONSUMER ADVOCATE WHO WOULD BE SOLELY RESPONSIBLE FOR REPRESENTING THE CONSUMERS OF SOUTH CAROLINA BEFORE THE PUBLIC SERVICE COMMISSION.

LACK OF INFORMATION CONCERNING CONSUMER INTERESTS AND COMMISSION
ACTIVITIES

The Public Service Commission does not collect adequate information concerning the needs of the consuming public. In addition, the general public is not adequately informed as to the activities and regulatory priorities of the Commission.

This situation seems to stem from the fact that Commission activities and the need for public input were limited prior to the early 1970's. As stated in the previous finding, that period of regulatory inactivity has certainly ended.

The absence of a mechanism for ensuring effective exchange of this type of information results in a situation in which neither the Commission nor the public can adequately understand the other and in which the Commission can be accused of indifference to public needs. This factor was emphasized in a recent report on Federal regulatory agencies by the Oversight Subcommittee of the House Commerce Committee. This report called for major changes in Federal Power Commission operations due to that agency's "..... conscious indifference to the public."

RECOMMENDATION

PSC SHOULD ESTABLISH A PUBLIC AFFAIRS UNIT
WHOSE MAJOR RESPONSIBILITIES WOULD BE TO
COLLECT INFORMATION CONCERNING THE NEEDS AND
WISHES OF THE CONSUMING PUBLIC IN REGULATORY
MATTERS AND TO DISSEMINATE INFORMATION
CONCERNING COMMISSION ACTIVITIES AND REGULA-
TORY PRIORITIES AND PHILOSOPHIES.

CHAPTER III

EXAMINATION OF FUEL ADJUSTMENT CLAUSE

INTRODUCTION

As a part of the PSC audit, the Council performed an in-depth analysis of the use and monitoring of Automatic Fuel Rate Adjustment (AFRA) Clauses. The Council reviewed the policies, procedures, and practices employed by the Commission in the performance of its duties in regard to fuel adjustment clauses. To do this, numerous interviews were conducted with agency and utility personnel including technical, professional, and administrative staff. Also, utility reports, independent audit reports, financial and statistical statements, audit working papers, and other documents were studied closely in order for the Council to form an opinion of the Commission's performance.

SUMMARY OF FINDINGS

- (1) With the exception of (2) below, the Council found that PSC's monitoring of the Fuel Adjustment Clause was, for the most part, adequate to prevent inappropriate utilization of the clause.
- (2) The Council found that studies of generation/purchase mix were needed to ensure that consumers are getting the benefit of the lowest priced energy and to ensure that generation/purchase mix is efficiently managed by utilities.

THE NATURE OF AFRA CLAUSES

Before discussing the history of AFRA clauses, it is necessary to understand what an AFRA clause is and what it does. The clause

is essentially a formula by which the increased or decreased cost of fuel is computed and distributed to consumers. The cost is reflected in the consumer's monthly bill as "fuel rate adjustment" or "fuel adjustment". In recent years consumers have become concerned about the increasing costs of their utility bills, especially the cost of electricity. Generally, the public does not understand the fuel rate adjustment because it is a combination of complex engineering and accounting concepts placed into a formula for cost recovery. This has contributed to a public sentiment of mistrust of utility companies. The Commission has been aware of the public's concern and has made some effort to alleviate that concern. PSC publication "Resume of Fossil Fuel Adjustments" dated May 8, 1975 states:

"The single major difficulty we have encountered in the use of fuel clauses is the rapid increase in the cost of electric service to the consumer which has imposed a real economic burden on a large group of users in our State. The most severe period was

from September, 1973 to December, 1974. We just experienced public disenchantment with the fuel adjustment clause which has not, as yet, produced a viable alternative.

Our Commission has made several attempts to improve communication in this area. The fuel adjustment portion of electric charges was originally billed aggregately with base rate charges. After public concern over fluctuations in per KWH costs, we required the presentation of the factor on the bill. This was not successful in clarifying the impact of fuel costs on the billing and in fact seemed to contribute to misunderstanding. Consequently, the factor was removed from the bill and the dollar amount attributable to the fuel factor was isolated on the bill and captioned as "Fuel Adjustment".

This has been very successful in isolating for the ratepayer exactly what has caused his bill to rise, but it has not relieved public disenchantment with the clause."

HISTORY AND PURPOSE OF AFRA CLAUSES - SCOPE OF REVIEW

Some AFRA clauses were used prior to the late 1940's although it was not until that period that the use of the clauses became generally acceptable for industrial consumers and later expanded to residential consumers. The use of AFRA clauses has been requested by utilities in periods of rapidly rising cost; however, it is the intent of PSC to continue the use of clauses through periods of economic stability. This will ensure that the benefits of reduced or stabilized fuel costs will continue to be passed on to consumers. During the period 1973 to 1975, the cost of coal more than doubled. The fuel cost problem was not limited to South Carolina but was both a national and international problem. The Commission recognized that fluctuating fuel costs placed a large monetary burden on the utilities and that such fluctuations would necessitate frequent rate hearing requests. The Commission considered it impractical to conduct numerous major electric utility hearings every year. To offset the anticipated number of hearings, utilities were and are allowed to pass the increased or decreased cost of fuel to the consumer via the fuel adjustment clause. The first residential fuel adjustment clause under the jurisdiction of PSC went into effect on April 30, 1970. Two others followed in 1974. Most of the clauses of the early 1970's were designed to recover the costs of coal; however, the Commission now intends to adjust clauses to include the cost of nuclear and other fuels when the need arises. The Commission feels that this will allow consumers to benefit more from the current lower cost of nuclear production.

To examine the use of fuel clauses in South Carolina, the Council reviewed the methods by which PSC monitors the utilities' application of AFRA clauses and found the following explanation of the procedure:

"Our monitoring program is composed of three related approaches:

- (1) We have required the three companies to file monthly reports to assist us. General areas of reporting include fuel stocks, purchase and burned costs, costs per MBTU, revenues booked and collected, adjustment computation, and over or under recovery of cost above base.
- (2) We have obtained an Auditape System and time on a computer to help conduct field audits to determine the reliability of the reports.
- (3) Extended reviews are conducted to answer questions which come to our attention.
 - (a) Coal contract provisions.
 - (b) Coal and oil price differences between companies.
 - (c) Change in prices per ton by vendor over the last two years.
 - (d) The effect of the fuel clause computation method on the distribution of cost among ratepayers.
 - (e) Comparison of revenue and expense matching between companies."

The Council reviewed the reports required from utilities by the Commission and found that numerous reports are submitted monthly, quarterly, and yearly. The reports contain detailed information with regard to fuel purchase, use, and fuel adjustment computation and provide a sound basis for the monitoring of fuel adjustment clauses. Also, on-sight audits of fuel accounts are performed by the Commission staff. During the period July 1, 1975 to June 30, 1976, a fuel audit was performed on each of the major electric utilities, i.e., Duke Power, CP&L, and SCE&G. The Council found that during 1976 and for previous years the Commission had assigned one

auditor on a full time basis to monitor fuel adjustment clauses. The Commission indicated that two auditors are currently assigned to review the application of fuel adjustment clauses, and that fuel audits will be performed on each major utility every six months. For customers who complain of high bills or unfair charges, the Commission engineers check meters for mechanical reliability, and recompute fuel adjustment rates and amounts charged to ensure accuracy. The engineers have made on-site inspections of all the major electric utility laboratories to examine the general procedures and standards used for testing coal samples for heat content. Currently, the engineers are scheduling the laboratories for more detailed examinations.

Public Service Commission auditors utilize an Auditape System which allows the retrieval, verification and independent analysis of the information stored in a utility's computerized data system. In addition, both the auditing and engineering staff prepare special reports to aid the Commissioners in decision-making. Although any type of special report needed by the Commissioners would be prepared, some typical examples are comparisons of fuel prices, rate structures, and companies' revenue and expense. The Commission has received approval in its current budget to hire an economist. This should enable the Commission to perform more detailed analyses and projections on future needs.

As a further review of the effectiveness of the monitoring of fuel adjustment clauses by PSC, the Council selected specific areas where public concern has been expressed. Areas where utility companies in other States have been found to abuse the intent of

AFRA clauses were examined. The Council selected SCE&G for a case study. In addition, Duke Power and CP&L were examined and are mentioned in some areas of the review.

LEGALITY OF AFRA CLAUSES

Some State laws do not permit regulatory agencies to utilize AFRA clauses. Such clauses are considered to bypass the mandated duties of the agencies by allowing the cost of fuel to be passed directly to consumers without allowing consumers a public hearing for each increase. However, the PSC Commissioners stated that AFRA clauses are a legal and necessary mechanism for passing fuel costs to consumers. Since the Council's review of the State laws governing PSC revealed no definitive answer as to whether the allowance of fuel adjustment clauses is in violation of the mandated duties of the Commission, the Council requested an opinion from the Office of the Attorney General as to whether the utilization of a fuel adjustment clause bypasses the regulatory authority of the Public Service Commission. The Office of the Attorney General's response dated August 5, 1976, was:

"Based on research memoranda compiled by this Office, it is our opinion that the use of a fuel adjustment clause does not bypass the regulatory authority of the Public Service Commission."

CONCLUSION

Based on the Attorney General's opinion, the Council concluded that the use of the AFRA clause by PSC does not bypass the regulatory authority of the agency.

ARE AFRA CLAUSES NECESSARY?

Consumers have wondered whether fuel adjustment clauses are needed by utility companies. In order to make a determination, the Council addressed the primary reason why utility companies say AFRA clauses are necessary. Utilities have claimed that the cost of fuel has increased (and in some cases decreased) so rapidly that without a means by which to pass the increased cost of fuel on a timely basis to the consumers, the companies would be forced to request almost monthly rate hearings.

Since the need for fuel adjustment clauses is based on fluctuating fuel costs, the Council noted the changes in the average dollar cost per ton of coal for the South Carolina Electric and Gas Company and the Duke Power Company from September, 1973 to May, 1976.

Schedule of Average Monthly Cost of Coal Per Ton

From September, 1973 to May, 1976

	<u>SCE&G</u>	<u>DUKE POWER</u>
September, 1973	\$14.01	\$11.79
January, 1974	16.96	14.99
June, 1974	29.97	21.46
January, 1975	34.55	26.71
June, 1975	28.21	29.57
January, 1976	25.97	25.24
May, 1976	24.92	25.84

Source: PSC Monthly Report: Summary of Coal Purchased.

The Council observed that from September, 1973 to January, 1975, the average cost per ton of coal more than doubled for both utility companies. Also, the average cost of coal tended to decline in 1975 and, for the present, seems to have leveled off.

Another part of the underlying assumption of the need for fuel adjustment clauses is that fuel costs have fluctuated so vastly that utilities would not be able to maintain a reasonable level of financial stability and investor desirability without the ability to pass through frequent fuel cost increases. To obtain an idea of the degree of impact which the doubling of coal prices had on the utility industry, the Council compared SCE&G's cost of fuel used in generation to the company's total operating expenses (which also includes coach and gas operation).

Comparison of SCE&G Cost of Fuel for Electric Generation to
Total Operating Expense from December, 1972 to June, 1976

Period 12 Mos. Ended	(a) Cost of Fuel Used in Electric Generation	(b) Total Operating Expense	Percentage (a) ÷ (b)
December, 1972	\$ 45,550,422	\$ 140,566,587	32. %
December, 1973	52,014,899	162,963,148	32. %
December, 1974	104,993,235	230,891,753	45. %
June, 1975	119,111,969	262,086,653	45. %
December, 1975	109,649,483	262,393,606	42. %
June, 1976	109,772,778	272,678,483	40. %

Source: PSC Monthly Report: Financial and Operating Report.

From the comparison it was observed that in December 1973, fuel was 32% of operating expense and by December, 1974 had risen to 45%. It is evident that the 13% increase in a one year period was caused primarily by fuel cost increases. The Council noted that there was a significant relationship, and it is likely a significant impact could have occurred to the detriment of both the utility and the consumer if the AFRA clause had not been utilized.

CONCLUSION

The Council concluded that AFRA clauses are necessary and equitable so long as both fuel increases and decreases are treated under the clause.

FIXED EFFICIENCY AND VARIABLE EFFICIENCY

Efficiency ratios are used in fuel adjustment clauses to determine the amount of adjustment which will ultimately be charged to consumers. Efficiency ratios are a measure of the number of kilowatt-hours (KWH) produced from an amount of fuel by a specific plant, in actuality a measure of plant efficiency. Individual plant efficiency ratios are averaged for all the plants used by a utility to determine the efficiency ratio of the system. A system's efficiency can be improved through time with the addition of new and more efficient plants. If a fuel adjustment clause was based on a fixed efficiency ratio (one that did not change as plant efficiency changed), it is possible that the consumer may not benefit when new plants cause increased system efficiency.

The Council found that SCE&G had been allowed to use a fixed efficiency ratio in its clause. (Duke Power and CP&L used variable efficiency ratios.) The PSC fuel adjustment specialist stated that

the efficiency was fixed at 10,000 BTU until the new clause went into effect on April 1, 1976.

The Council found no evidence that the Commission had computed any possible over or under charges as a result of the fixed efficiency clause. It appeared that the Commission felt that the method was fair at the time but that it would be more practical to have all three of the major utilities on a variable efficiency clause after that period.

To determine what effect the fixed efficiency clause had on the cost of electricity charged to consumers, the Council compared the actual efficiency of SCE&G to the fixed efficiency allowed in the AFRA clause for the period 1971 to 1975.

Comparison of SCE&G's Fixed Efficiency to Actual Efficiency
Measured in BTU's for the Period 1971 to 1975

<u>Year</u>	<u>Fixed Efficiency</u>	<u>Actual Efficiency</u>	<u><Over Recovery></u> <u>Under Recovery</u>
1971	10,000	9,962	< 38 >
1972	10,000	9,783	< 217 >
1973	10,000	10,179	179
1974	10,000	10,219	219
1975	10,000	10,032	32
1976	(Changed to variable efficiency).		

Source: NARUC Reports, SCE&G Reports.

When the fixed efficiency is greater than the actual efficiency the company is over recovering its costs, and when the fixed efficiency is less than the actual efficiency, the company is under recovering its costs. It was noted that during 1971 and 1972, the company over recovered its costs; however, from 1973 to 1975, the company under recovered its costs.

CONCLUSION

The Council concluded that the use of a fixed efficiency clause from 1970 to 1975 may have resulted in both over and under recovery of costs by the utility company but in the overall view the consumer was apparently protected from significant abuses.

GENERATION MIX

Generation mix is a term used to describe the types of plants involved in the production of energy, for example; nuclear, coal, oil, or hydro. Since the energy produced from different plants can cost more or less depending on the type of fuel used in the plant, it is necessary that AFRA clauses be designed and monitored to ensure that consumers are not charged more than the actual cost of fuel for the plants providing the energy. In essence, consumers must be assured that they are not paying for fuel cost increases in excess of a utility's system-wide average fuel cost increases.

The Council reviewed the fuel clauses allowed by PSC and other documentation, and found that SCE&G had included its hydro generation in its fossil fuel adjustment. The manner in which it was included caused an over recovery of costs from the consumer.

The following is an excerpt from PSC Docket #18,362-Order Number 19,002 dated February 4, 1976, in which the Commission recognized and resolved the problem of generation mix in the use of the SCE&G fuel adjustment clause.

"What has caused this Commission considerable concern is that SCE&G in deriving the first factor has not excluded from its calculations that part of its generation which is generated from hydroelectric power. Obviously, such production does not involve fuel expense. It is completely improper for it to be included among the units of production associated with fuel expense. The company attempts to justify its inclusion of hydro generation on the basis that it has not considered either hydro generation or so-called line losses (i.e., losses of power incurred by the company from the point of generation to the point of receipt by its customers) as the company determined the two offset each other. To that extent, the testimony and figures so indicated that from June, 1970 to August, 1975, the line loss fuel expense not charged to the customer has exceeded the artificial hydro fuel expense charged by the company in the amount of \$1,759,835. It does appear, therefore, that the customers have, so far, not been overcharged by the company's application of the clause.

Two inaccuracies do not, however, even though offsetting, solve the problem that the fuel clause is not being applied with precision. The Commission strongly feels its responsibility to assure the public that AFRA clauses do operate with precision.

For these reasons, the Commission concludes that the company's clause should be changed into a KWH sales type AFRA clause. The nature of such a clause is that it accurately reflects the added fuel costs of the company associated with the units sold. Such a clause would, therefore, exclude any consideration of hydro generation in terms of fuel costs and would also properly treat the fuel costs above base cost associated with line losses."

CONCLUSION

The Council concluded that the Commission is aware of possible abuses of AFRA clauses with regard to generation mix, and that PSC's monitoring of generation mix appears to be adequate.

GENERATION/PURCHASE MIX

Utilities may exchange power with other utilities to take advantage of the generating plants which may be more efficient than their own. If a fuel adjustment clause is based only on a company's own generating plants, the increased or decreased cost attained through exchange power may not be passed to the consumer. Also, there could be reduced incentive to purchase less expensively generated electricity when a utility knows that it can recover its increased costs for the operation of its own less efficient plants through its AFRA clause.

Based on an examination of the AFRA clauses allowed by PSC, the Council found that the clause for Duke Power Company included purchased power. However, the clauses for CP&L and SCE&G did not include purchased power. PSC officials stated that CP&L is now in the process of having its clause adjusted to include purchased power, and SCE&G has a similar adjustment pending its next hearing. The Council noted that PSC had not performed specific studies of the individual utility companies to determine what effect generation/purchase mix may have had on charges to the consumers.

CONCLUSION

The Council concluded that potential problems may exist in the area of generation/purchase mix.

RECOMMENDATION

THE COMMISSION SHOULD MEASURE WHETHER THE UTILITIES HAVE BEEN EFFICIENTLY MANAGED IN THIS RESPECT BY PERFORMING DETAILED STUDIES OF EACH UTILITY FOR THE

PERIOD PRECEDING THE INCLUSION OF PURCHASED POWER
IN THE COMPANIES' AFRA CLAUSES.

FUEL ACCOUNTS

Consumer groups have expressed concern that utilities have been allowed to pass through costs other than fuel, which may be unaffected by market fluctuations, by including the costs in fuel accounts. The handling of fuel accounts in such a manner could result in overcharges to the consumer.

PSC auditing personnel stated that currently the expenses allowed to be passed through are only those of fuel and freight which is directly associated with fuel delivery. However, CP&L had previously been allowed to include some handling and overhead charges in its fuel costs. PSC accountants stated that since the base rate allowed in the clause represents less than the actual cost to produce a KWH, and since fluctuating fuel costs cause nearly all of the change there is no overpayment by the consumer. PSC auditors as a normal part of utility audits, review and test fuel accounts to ensure that only the proper fuel costs are passed to consumers via AFRA clauses.

The Council recomputed selected SCE&G fuel adjustments and found that handling charges and overhead were not included in the fuel costs.

CONCLUSION

The Council's examination indicated that current monitoring of fuel accounts by the Commission appears to be adequate. The

Commission should continue its review and testing of fuel accounts as a normal part of the Commission's audit scope to ensure that only the proper fuel costs are passed to consumers in fuel adjustment charges.

FUEL INVENTORY METHODS

Another area of concern is the treatment of fuel inventories by utility companies. If a utility were to charge the consumer the current cost of fuel each month in an AFRA clause, the consumer could be paying more than the actual cost of the fuel paid by the company. The company could over recover its costs for fuel. For example, in one month a company paid \$15.00 for a ton of coal which was placed in its stockpile, and the next month the company paid \$25.00 for a ton of coal, and during the second month the company burned both tons of coal. If the company charged the current price of \$25.00 per ton for both tons of coal, the consumer would be paying \$50.00 for two tons of coal which cost the utility only \$40.00. The utility would have received \$10.00 more than necessary. On the other hand, if the utility had averaged the two purchases (that is \$15.00 plus \$25.00 equals \$40.00, divided by 2 equals \$20.00 per ton) and the utility charged the consumer for two tons at \$20.00 each, the utility would not have over recovered the cost of fuel.

PSC officials stated that utilities are expected to use the weighted inventory averaging method for fuel costs. It is a normal part of the audit of utilities to review and test the fuel inventory procedures of the companies. The failure to comply

with the expected inventory procedure could result in adjustments to statements presented to the Commissioners and/or refunds to the consumer.

CONCLUSION

It appears that the Commission's monitoring procedure for fuel inventory is adequate. The Commission feels that inventory averaging is the most equitable method now available. The Commission should continue its review and testing of fuel inventory procedures as a normal part of the Commission's audit scope to ensure that the most equitable treatment of inventories is achieved.

ESTIMATED FUEL CLAUSES

Some utilities throughout the nation have been allowed to use fuel adjustment rates based on estimated sales for up to a year in advance. Estimated clauses are viewed by consumer groups as one of the greatest sources of excess revenue for power companies. Such clauses are said to make consumer questioning of expense figures nearly impossible.

The Council's review of the fuel adjustment clauses allowed by the Commission indicated that no long term estimated clauses were allowed. The Council found that SCE&G had been allowed to use an estimate of current fuel costs while adjusting the estimate to actual costs sixty days later. The Commission recognized that SCE&G was incurring a temporary over collection of fuel costs and resolved the matter as stated in PSC Docket Number 18,362 - Order Number 19,002 February 4, 1976, an excerpt of which follows:

"The second major area of concern which this Commission has with regard to SCE&G's AFRA clause is the manner of collection which is utilized by the company. Under its present tariff, the company uses what may be called a 'two-step' (two factors being utilized) method of charging its customers for added fuel expense. Since the company seeks to apply its clause on a current basis, it necessarily must use an estimate of the current fuel cost as its initial fuel factor. Such initial factor is computed by the company utilizing its most recent historic cost, i.e., the actual fuel cost from sixty days previous, and applying that cost to the current month's usage. Since the current month's fuel costs may vary from the costs used in the initial factor, i.e., actual fuel cost sixty days previous, the company makes a second adjustment or 'correcting factor' sixty days later to correct the amount charged to the actual cost of fuel during the month of billing. While this approach attempts to allow current recoveries of fuel costs by applying the most recent fuel costs to the actual usage by each customer during the billing month, this form of an AFRA requires the second adjustment which causes a sixty-day delay in arriving at the correct charge. This second factor has caused considerable confusion among the company's customers since it is almost impossible for them to correctly calculate the exact fuel charge which they are paying. In addition, when fuel prices are declining, which has been the situation from January 1975 to October 1975, the company's initial factor will be higher than the current cost, resulting in a temporary over collection of fuel costs by the company. This temporary over collection has been corrected by the exact adjustment sixty days later but the company has had sixty days use of some of its customer's funds without charge when this method is used and we determine that to not be in the consumer's interest.

For these reasons, the Commission has concluded that the company's method of charging its customers should be changed. The company is therefore directed to apply its AFRA clause on the basis of actual costs applied to usage in the period the costs were incurred; however, the collection may be deferred for thirty days to enable the company to use such actual cost of fuel. This will eliminate the second adjustment or correcting factor and should alleviate some of the confusion in the public's mind concerning this aspect of the fuel clause. Such a deferral does, however, have the disadvantage of increasing the company's carrying costs since a thirty-day

delay in recovery of fuel costs will be experienced by the company. For this reason the Commission is of the opinion that the company should increase the proportion of the fuel cost included in its base rates to a more current level. It is noted that such an adjustment will not increase or change the rates as they apply to each individual customer. It will, however, include more of the current fuel cost in the base rate and less under the AFRA clause.

CONCLUSION

The Council concluded that PSC's monitoring of AFRA clauses does not allow utilities to over recover costs as a result of the use of estimated AFRA clauses.

INCENTIVES FOR EFFICIENCY

Consumer groups have expressed concern that AFRA clauses reduce or eliminate incentives for utility efficiency. Since AFRA clauses allow increased fuel costs to be passed to consumers, it would appear logical that utility companies do not need to purchase the lowest cost fuel for energy production.

To determine the validity of the assumption, the Council sought reasons from the PSC Commissioners as to why efficiency may or may not be reduced with the allowance of AFRA clauses. In general the Commissioners thought that the use of the clauses was necessary and that no realistic alternatives were currently available. With close monitoring by PSC and utility competition to produce energy at the lowest cost, the Commissioners felt that AFRA clauses did not reduce or eliminate incentives for utility efficiency. The Commissioners emphasized that PSC audits procurement procedures and fuel costs, and, during the course of rate hearings, questions any broken fuel contracts.

CONCLUSION

The Council concluded that, although reduced incentives for utility efficiency are inherent in the use of AFRA clauses, proper AFRA clause design and effective monitoring may help to provide some incentive for efficient energy production. PSC's actions indicate that clause design and monitoring are priority concerns of the Commission.

CHAPTER IV

EXAMINATION OF ADMINISTRATIVE PROCEDURES FOR EFFICIENCY AND ECONOMY

INTRODUCTION

It is especially important for an operational audit to address efficiency factors as deliberately and as completely as possible. In order to do this the Legislative Audit Council first examined the written policies and procedures used by the Public Service Commission to perform its functions. These procedures included such areas as personnel management, travel, bookkeeping, property management, etc. In addition, the Council examined the agency's travel and subsistence practices.

SUMMARY OF FINDINGS

(1) Lack of Adequate Written Administrative Procedures

PSC has not developed adequate written procedures in the administrative areas of bookkeeping and property management.

(2) Need for Improved Property Control

PSC's property records have not been reconciled to the actual inventory of the agency. The lack of accurate property records can result in property being lost, misused, or stolen without the agency's knowledge.

(3) Lack of Adequate Travel and Subsistence Procedures

PSC's travel procedures are not sufficient to ensure that public funds available for travel are utilized in accordance with State regulations.

(4) Questionable Allowances for Meals

PSC Law Enforcement Officers are claiming meal reimbursements which appear to be in violation of State regulations.

(5) Questionable Subsistence for Commissioners

The 1976-77 Appropriation Act allows Commissioners to receive subsistence regardless of their place of residence while State regulations prohibit the payment of subsistence to employees within 40 miles of their residence.

LACK OF ADEQUATE WRITTEN ADMINISTRATIVE PROCEDURES

In the case of PSC, the lack of formal, written procedures in some areas made in-depth analyses difficult. Policies and procedures have a direct affect on the efficiency and effectiveness of an agency.

Often the terms "policy", "procedure", and "practice" are confused. However, by strict definition "policy" is a course of action which has been selected to guide and determine present and future decisions. For example, it is the policy of the State Budget and Control Board that travel be accomplished by the most economical method. A "procedure" is a particular way of accomplishing something, in this case the goals of a policy. For example, a procedure to ensure the most economical means of travel may require a comparison of costs for different modes of transportation. A "practice" is the actual performance of an activity. The act of comparing the costs of different modes of transportation and utilizing the least expensive mode is therefore a practice.

The Council's review of PSC's internal policies, procedures and practices revealed that the agency had not adequately developed needed written procedures in the administrative areas of bookkeeping and property management. Details are provided in the following paragraphs.

Bookkeeping Procedures

PSC had not developed adequate written procedures for its bookkeeping activities. Written procedures for the administration and control of activities are a generally accepted factor in good management systems. Such practices enable agencies to recognize strengths and weaknesses of internal control. Without them accountability for the efficient and economical utilization of resources is reduced. For example, PSC's head accountant took an early retirement due to illness. His unexpected departure and the lack of written procedures describing accounting duties and responsibilities created a hardship on the agency in having the position properly filled.

The lack of written procedures makes it difficult for agency personnel who are unfamiliar with specific duties and requirements to perform those duties without the assistance of experienced personnel, at least in the initial stages. If written procedures had been available, the transition of personnel would have been less time consuming and more efficient.

Property Management Procedures

The Council noted that the agency does not have written procedures governing the control of agency property, although

the agency does currently record and label property as it is procured.

Generally accepted accounting principles require the development of a system of internal controls which ensures the safeguarding of property. Such control is achieved through the maintenance of records derived from actual invoice information, the physical inspection of equipment, periodic inventories, and the reconciliation of property records.

RECOMMENDATIONS

PSC SHOULD DEVELOP AND UTILIZE A MANUAL OF ADMINISTRATIVE PROCEDURES. ALL PROCEDURES SHOULD INCORPORATE STATE REQUIREMENTS AND GOOD MANAGEMENT PRACTICES TO ENSURE THAT EFFICIENCY WILL BE ACHIEVED. IN GENERAL THE PROCEDURES SHOULD BE CLEAR, CONCISE, AND COMPLETE ENOUGH TO:

- (1) SPECIFICALLY RELATE THE DUTIES AND RESPONSIBILITIES TO ALL PERSONNEL AFFECTED BY THEM,
AND
- (2) PROVIDE A STEP-BY-STEP DESCRIPTION OR PROCEDURES AND PROCESSES FOR THE ACCOMPLISHMENT OF POLICY OBJECTIVES.

SPECIFIC WRITTEN PROCEDURES IN THE AREAS OF BOOKKEEPING, PROPERTY MANAGEMENT, AND TRAVEL SHOULD BE DEVELOPED OR, WHERE SOME PROCEDURES DO EXIST, THEY SHOULD BE EXPANDED AND REFINED. PSC SHOULD RECOGNIZE THE NEED FOR AND DEVELOP PROCEDURES FOR ALL AREAS WHERE THE AGENCY CAN ENHANCE EFFICIENCY.

PSC SHOULD DEVELOP AN ACCOUNTING POLICIES AND PROCEDURES SECTION TO BE INCLUDED IN THE RECOMMENDED MANUAL OF ADMINISTRATIVE PROCEDURES. IT SHOULD DEFINE ACCOUNTING PROCEDURES AND POLICIES, DESCRIBE THE VARIOUS FUNDS AND THEIR PURPOSES, AND INCLUDE A CHART OF ACCOUNTS WITH APPROPRIATE DESCRIPTIONS, PURPOSES, AUTHORIZED USAGES, AND CONTENTS OF EACH ACCOUNT. IT SHOULD ALSO INCLUDE STEP-BY-STEP INSTRUCTIONS, DIAGRAMS OF PAPER FLOW, AND INSTRUCTIONS ON OFFICE ROUTINES.

PSC SHOULD ESTABLISH WRITTEN PROCEDURES FOR PROPERTY CONTROL. THESE PROCEDURES SHOULD DESCRIBE THE AGENCY'S RECORDS SYSTEM WHICH IS BASED ON INVOICE/PURCHASE INFORMATION AND PHYSICAL INSPECTION UPON RECEIPT. THE PROCEDURES SHOULD SPECIFY BOTH THE TIMING OF PHYSICAL INVENTORIES AND RECONCILIATION OF RESULTS TO THE AGENCY'S PROPERTY CONTROL RECORDS.

NEED FOR IMPROVED PROPERTY CONTROL

PSC property records had not been reconciled to the actual inventory of the agency. The agency has a property card file which contains 894 active cards. Each card contains information about one piece of equipment. The agency performed a complete physical inventory in February 1976 during which 1,030 individual items of equipment were located. 136 items (13%) of the equipment found to be on hand were not identified in the agency's property inventory control file. Also, according to the record of physical inventory, 330 items were not identified by agency assigned property decals as is the normal practice.

The agency's accountant stated that it was a standard practice that an inventory be conducted annually; however, the exact date of an inventory prior to February 1976 could not be recalled.

The lack of accurate property records can result in property being lost, misused, or stolen without the agency's knowledge. The end result is an unnecessary loss of public resources. Reconciliation of the results of physical inventories to property control records is an essential element in accountability for property.

RECOMMENDATION

PSC SHOULD IMMEDIATELY RECONCILE ITS PHYSICAL INVENTORY OF FEBRUARY 1976 TO ITS PROPERTY RECORDS, AND INVESTIGATE ANY DIFFERENCES.

LACK OF ADEQUATE TRAVEL AND SUBSISTENCE PROCEDURES

The Council found that PSC had not developed written procedures or practices to ensure that funds available for travel would be utilized in accordance with State regulations. The Budget and Control Board Regulations for Reimbursement for Travel and Subsistence Expenses state:

Travel and transportation on State expense will be authorized only when officially justified and by those means which meet State Government requirements consistent with good management practices.

A traveler on official business will exercise the same care in incurring expenses and accomplishing an assignment that a prudent person would exercise if traveling on personal business. Excess costs, circuitous routes, delays or luxury

accommodations unnecessary or unjustified in the performance of an assignment are not considered acceptable as exercising prudence. Travel by commercial airlines will be accomplished in coach or tourist class, except where exigencies require otherwise. Transportation to and from points of arrival and departure will be accomplished by the most economical method.

It is the duty and responsibility of the respective department heads to ensure compliance with these regulations. (Emphasis Added)

The following sections address specific areas where improved accountability is needed.

Actual Expenses Not Documented

PSC's documentation requirements for travel and subsistence expenses were found to be inadequate. While standard reimbursement vouchers are used in accordance with State regulations, PSC does not require receipts for lodging expenditures. The absence of these receipts results in agency administrators being unable to verify the validity and amount of expenditures.

In addition, the Council's review of travel disbursement vouchers showed that all claims for reimbursement of travel expenses examined, except one, were for the maximum amount allowed by State regulations. This brings into question the legitimacy of the reimbursement requests. State travel regulations specify that "...employees shall be allowed reimbursements for actual subsistence expenses incurred and paid" not to exceed the established ceiling rates. (Emphasis

in the original) The absence of documentation makes it impossible to determine whether reimbursement requests were for the actual amount and whether the expenses were justified.

This results in increased potential for errors, misrepresentation, and fraud. Further, the agency is unable to ensure that travel funds appropriated to it are utilized in the most efficient and economical manner possible.

Prior Approval and Persons Traveling Together

PSC does not have adequate procedures to document the prior approval of travel. Also, the agency does not have adequate procedures to document trips when employees travel together. The Council found sign-out sheets from which some information could be obtained; however, the methods for documentation and the maintenance of the records were at the discretion of the divisions within the agency. The documentation was not complete and not readily available for management when reviewing requests for travel reimbursements.

In order for management to ensure that review and approval of travel are adequate, information must be readily available for prior approval.

Inadequate review and approval procedures for travel have resulted in the uneconomical and inefficient use of funds by the agency. In one case an individual traveled out of State by auto. The cost of the salary, subsistence, and mileage was \$1,787.24. If the employee had utilized air transportation, the cost would have been \$1,044.70. The difference, \$742.54, could have been saved.

In another instance, three employees traveled to Atlanta, Georgia. Each employee drove a privately-owned car, and each employee departed and returned within one hour of the others. The milcage cost for each employee was \$59.64. If the employees had traveled together, the mileage cost would have been only \$59.64 rather than \$178.92 for the three. If the agency had conducted a proper review prior to the trip, a savings of \$119.28 could have been realized.

In another case seven employees traveled to Williamsburg, Virginia. Six of the employees traveled by privately-owned vehicles and claimed a total of \$785.72 for milcage reimbursements. If the employees had traveled together, three in one car and four in another car, a savings of \$564.56 would have been realized.

Purpose of Trips

The agency does not require documentation stating the purpose of trips taken and the benefit of such trips to the agency. The Council found no written procedures which required the documentation of purpose or benefit information. As a result of the lack of documentation, the agency's management personnel are not afforded information which would ensure the efficient use of funds available for travel. The proper documentation of the purpose of travel could reduce unnecessary travel and result in a savings to the agency and the public.

RECOMMENDATIONS

- (A) PSC SHOULD REQUIRE THAT ALL REIMBURSEMENT REQUESTS FOR OVERNIGHT TRAVEL BE DOCUMENTED BY RECEIPTS FOR LODGING EXPENSES AND SHOULD ENSURE THAT ALL TRAVEL REIMBURSEMENTS ARE FOR ACTUAL EXPENSES AS REQUIRED BY STATE REGULATIONS.
- (B) PSC SHOULD DEVELOP AN AGENCY-WIDE PROCEDURE FOR PRIOR APPROVAL OF TRAVEL. DOCUMENTATION SHOULD BE READILY AVAILABLE FOR MANAGEMENT WHEN REVIEWING AND APPROVING TRAVEL EXPENDITURES.
- (C) PSC SHOULD REQUIRE THAT THE PURPOSE AND BENEFITS TO THE AGENCY OF ALL TRIPS TAKEN BE DOCUMENTED AND THAT THE MOST ECONOMICAL MEANS OF TRANSPORTATION BE UTILIZED.

QUESTIONABLE ALLOWANCES FOR MEALS

PSC Law Enforcement Officers are claiming meal reimbursements which appear to be in violation of State regulations. PSC officially interprets the Budget and Control Board's regulation on travel to allow officers to claim subsistence when they are over ten miles from their place of residence and/or headquarters. The State regulations for reimbursement for travel and subsistence expenses are as follows: "no reimbursement will be permitted for subsistence unless the employee is over ten miles from his place of residence and/or headquarters. Permanent place of employment is the location of the place of activity where a State employee is regularly assigned and performs work..." (Emphasis Added)

Section 131 of the Appropriations for 1976-1977, State of South Carolina, states in part "When an employee is assigned to a particular territory or district, and such territory or district and his official headquarters are in different localities, or sections of the State, expenses may be allowed for necessary travel to his official headquarters." (Emphasis Added)

Based on the above, law enforcement officers assigned to areas of duty should not be allowed reimbursement for meals while working in their assigned areas. However, subsistence may be allowed for necessary travel from the assigned area to agency headquarters (Columbia).

Concurring with this interpretation is the practice employed by the South Carolina Highway Department. Highway patrolmen are allowed to claim subsistence only when directed or ordered out of their respective territories.

The allowance of reimbursement for meals by PSC results in an approximate cost of \$18,000 yearly. Agency officials stated that law enforcement officers spend about two-thirds of their time in their districts. This means that about \$12,000 of the yearly cost could be saved by compliance with State regulations.

RECOMMENDATION

PSC SHOULD DISCONTINUE REIMBURSEMENT OF THE COST OF MEALS TO ITS LAW ENFORCEMENT PERSONNEL, UNLESS THOSE PERSONS ARE DIRECTED TO PERFORM DUTIES OUTSIDE OF THEIR ASSIGNED AREAS.

QUESTIONABLE SUBSISTENCE FOR COMMISSIONERS

The 1976-77 Appropriation Act allows inequitable payments of subsistence of the Commissioners. All of the PSC Commissioners are allowed to receive \$25/day for subsistence. The Act states in part that "...each member of the Public Service Commission, regardless of the district he represents, may receive the same subsistence allowance as provided for members of the General Assembly for not exceeding five days in any week while in Columbia on official business." (Emphasis Added) It should be noted that the Commissioners are elected from each of seven districts covering the entire State and must travel to work in Columbia. The subsistence would therefore be needed to obtain food and lodging while in Columbia.

However, the Budget and Control Board Regulations for Reimbursement for Travel and Subsistence Expenses state that "no reimbursement for overnight accommodations will be permitted within 40 miles of the traveler's residence and/or headquarters."

The distance of 40 miles is considered the maximum reasonable distance that a State employee should have to commute without receiving reimbursement for overnight expense. Therefore, if Commissioners live within 40 miles of Columbia, the reimbursement of overnight expense is unnecessary. Based on the boundaries of the seven districts and as depicted in the chart, it is possible for as many as four Commissioners to have their permanent place of residence within 40 miles of Columbia.

Given a 200 day work year, this could result in a savings to the public of \$5,000 per year for each Commissioner living within

40 miles of Columbia. Currently, one Commissioner lives within 40 miles of Columbia.

Counties and Selected Cities or Towns Within Forty Miles of
Columbia by PSC District

<u>PSC District #</u>	<u>County</u>	<u>Cities/Towns</u>
2	Aiken	None
	Saluda	None
3	Newberry	Newberry
5	Kershaw	Camden
	Fairfield	Winnsboro
7	Richland	Columbia & vicinity
	Lexington	Lexington
		Ratesburg/Leesville
	Calhoun	St. Matthews
	Orangeburg	North
	Sumter	None
	Lee	None

Source: South Carolina, 1975 Primary Highway System Map.

RECOMMENDATIONS

THE PHRASE "REGARDLESS OF THE DISTRICT HE REPRESENTS,"
SHOULD BE DELETED FROM THE APPROPRIATION ACT.

SUBSISTENCE PAYMENTS TO COMMISSIONERS WHO RESIDE
WITHIN 40 MILES OF COLUMBIA SHOULD BE DISCONTINUED.

COMMENT

Although the subsistence payment is referred to as such in the law, it appears that the intent of the Legislature could have been to provide a supplement to the salaries of the Commissioners.

In that case the appropriate amount of funds should either (1) be placed in the personal service account of the agency and paid to the Commissioners on a per diem basis, or (2) be granted to the Commissioners as an annual pay increase.

PERSONNEL RECORDS SYSTEM - COMMENT

The Council's review of PSC's personnel records system indicated that personnel files were generally in order, and adequate attention was given to the physical security and the confidentiality of all personnel files. However, the Council considers that the records system would be improved by the development of a "checklist" of important and required documents which should be contained in each file. Each employee should be required to review his or her folder once a year, utilizing the checklist to verify that the records are current, accurate, and complete. The employee should note any discrepancies, sign, and date the checklist.

CHAPTER V
LEGISLATIVE AUDIT COUNCIL
REVIEW OF
CRESAP, McCORMICK AND PAGET MANAGEMENT REPORT

In April, 1970, Cresap, McCormick and Paget, Inc. (CM&P), a Management Consultant firm, issued a management study of the South Carolina Public Service Commission. This report was followed, in March 1976, by a Reconnaissance Study designed to evaluate the degree of implementation and current validity of the recommendations made in the Management Report.

During the course of this audit, the Legislative Audit Council reviewed the Cresap reports and performed their own evaluation of their recommendations.

The Legislative Audit Council made every effort to avoid duplicating the work already performed by Cresap, McCormick and Paget; however, some overlap was unavoidable because the agency could not be properly evaluated without examining some of the same areas addressed by the consultants. In addition, it was necessary to evaluate Cresap's recommendations using Legislative Audit Council criteria for effectiveness and efficiency. The following section reiterates the CM&P recommendations and includes the Council's comments.

- (1) THE PSC ORGANIZATION SHOULD BE REVISED - CM&P REPORT,
1976, P. VI

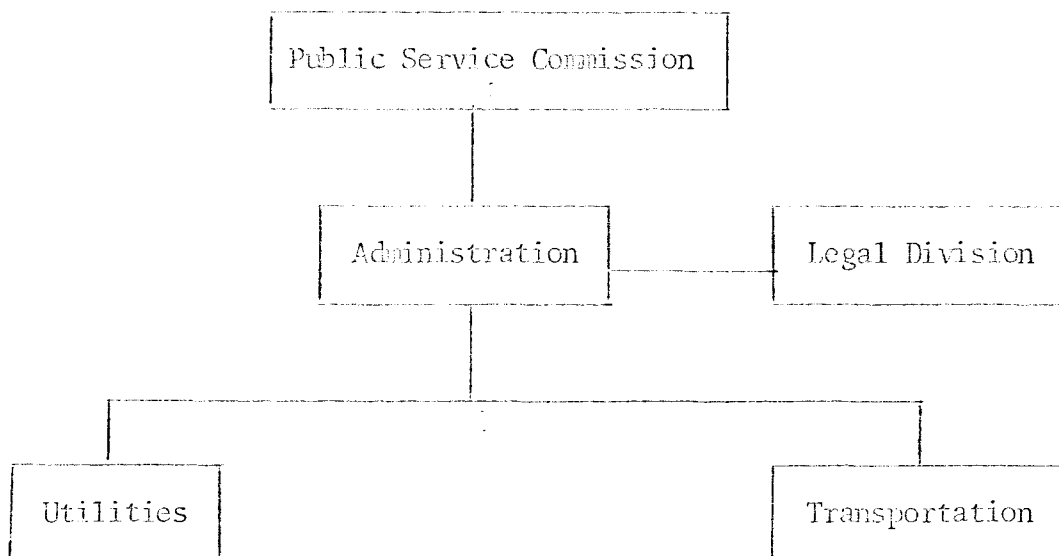
CM&P recommended changes in the organization of the

Public Service Commission that were essentially designed to incorporate the additional positions recommended by the consultant (see Recs. 3,6, 7, 8, 9 and 12).

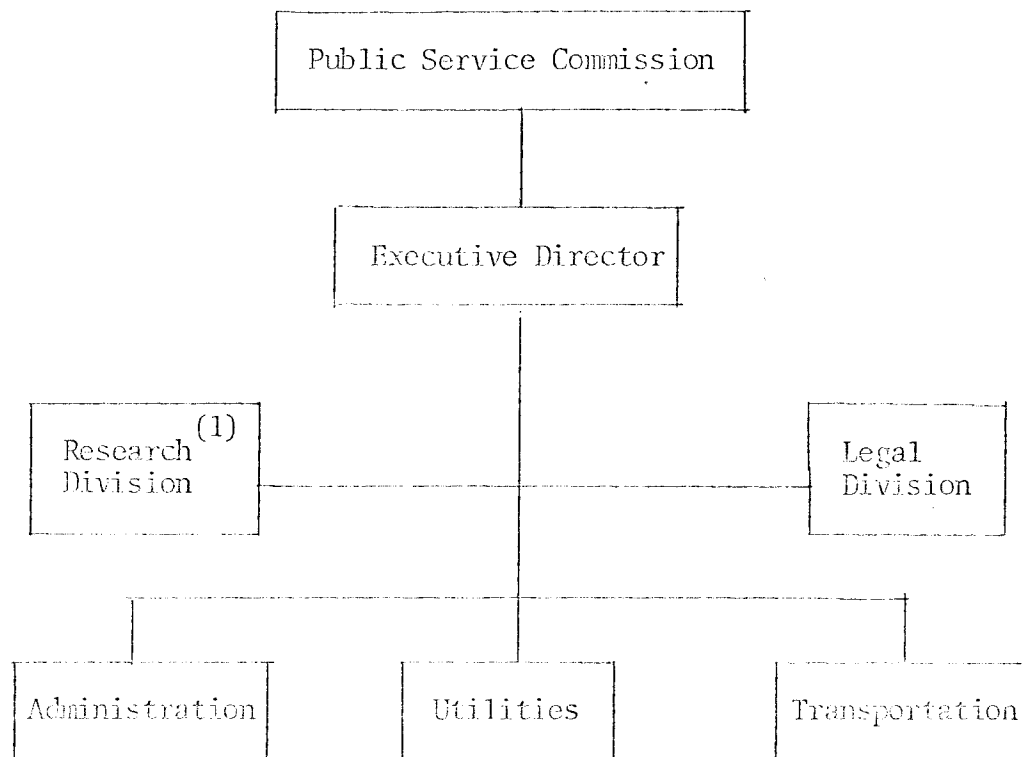
LEGISLATIVE AUDIT COUNCIL COMMENT

The Council does not concur with all the staffing changes recommended by CM&P (see below Rec. 7). However, it appears that the proposed modifications would serve to further emphasize the overall administrative role of the Executive Director. Placing the Executive Director in a direct line between the Commission itself and the supporting units of the agency is appropriate to the functions of the Executive Director's office (see, also, Rec. 3).

Present Organization -



CM&P Proposed Organization -



(2) SALARY LEVELS WILL REQUIRE SUBSTANTIAL IMPROVEMENT TO AVOID
A COLLAPSE OF PROFESSIONAL CAPABILITY (P. V2)

CM&P recommended that senior management staff salaries be reviewed and compared with salary levels in other States and that the salaries of the Commissioners be increased to \$35,000 from the present level of \$26,101 for the Chairman and \$23,879 for Commissioners. This latter proposal was based on the need to offer salary levels high enough to attract qualified senior staff who currently could not be paid more than \$500 less than the Commission Chairman, according to State Personnel regulations.

(1) Includes Utility Economist (See Rec. 6).

LEGISLATIVE AUDIT COUNCIL COMMENT

The Council feels that the salary review aspect of this recommendation should be expanded to include all professional staff positions, because the presence of qualified accountants, engineers and other staff professionals is vital to the preparation of quality rate case information and the effective monitoring of utility companies and services.

The Council disagrees with the reasons used to support an increase in the salaries of Commissioners. If salary levels equal to or surpassing that of the Commission Chairman are necessary to attract qualified senior staff, and such salary levels can be justified to the satisfaction of the Personnel Division, the appropriate regulations should be altered as warranted by the circumstances of the individual case. The current Appropriation Act provides the necessary alteration by stating "...that the salaries of the Chairman and the Commissioners as provided in this section shall not be construed as limiting the maximum salary which may be paid to other employees of the Public Service Commission" (p. 167).

Any decision concerning increases in Commissioners' salaries should be based on criteria such as workload and salaries for comparable positions in other States. Supplemental payments such as subsistence should be considered when such payments increase the actual salaries received by Commissioners. Any request should be completely justified to the General Assembly and should be accompanied by detailed

information concerning workload (including time and attendance records) and comparable salaries.

(3) A FULLY QUALIFIED EXECUTIVE DIRECTOR SHOULD BE RECRUITED
(PP. V3-6)

CM&P recommended that the Public Service Commission appoint an Executive Director whose basic responsibilities would include "...focus(ing) the attention of the Commission and the PSC staff on the efficacy of regulatory practices in securing the public good and supporting the economy of the State of South Carolina," and "...the administration and direction of staff activities."

LEGISLATIVE AUDIT COUNCIL COMMENT

The Council agrees with CM&P's recommendation that PSC appoint an Executive Director; however, any additional administrative expansion should be curtailed until such expansion can be analyzed in relation to its benefits to the public interest. At this time, the position has been approved by the Personnel Division and filled by the former Director of Administrative Services.

(4) A MISSION STATEMENT AND PRIMARY GOALS SHOULD BE ESTABLISHED
FOR EACH REGULATED UTILITY

CM&P recommended that the Public Service Commission develop mission statements designed "to clarify the purposes and objectives of the Public Service Commission and to serve as a guide to the development of regulatory programs, the

planning of staffing needs, and the establishment of responsiveness to likely areas of future public concern." The report further stated that the Commission's goal should be well-defined, include criteria for measuring goal achievement, and be non-procedural in nature (State goals to be achieved rather than the procedures for achieving those goals).

LEGISLATIVE AUDIT COUNCIL COMMENT

Goals and mission statement are vital to effective regulation. PSC has begun to develop goals and mission statements for regulated industries, but this task is not completed. PSC should consider this recommendation a priority. PSC should continue to develop overall non-procedural mission statements and criteria for measuring agency achievement of goals.

(5) RULES OF PRACTICE BEFORE THE COMMISSION SHOULD BE PROMULGATED (P. V7)

CNSP recommended that PSC adopt Rules of Practice delineating its procedures in rate cases.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Public Service Commission recently issued Rules of Practice and Procedure. The Council will examine this document to determine whether it meets the needs of the consuming public and others practicing before the Commission. The Council will notify the Commission of its findings upon conclusion of this examination.

(6) A RESEARCH DIVISION HEADED BY A FULLY QUALIFIED UTILITY ECONOMIST SHOULD BE ESTABLISHED (P. V8)

CM&P recommended that the Commission appoint a Utility Economist whose primary responsibilities should be to "...evaluate criteria for various decisions by the Commission whether defined by law or by Commission policy, and recommend changes in the best interest of the public," to provide "...technical and economic advice in hearings, particularly in rate cases" and to direct and perform general research not directly related to engineering.

CM&P also recommended that a research division be established to serve as a resource for the Executive Director and the Commission.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Legislative Audit Council examined this area and concurs with CM&P. In order for the Commission to fully develop their ability to monitor the efficiency of utilities in South Carolina, it is a must that a research unit be established. Through the development of utility models, industrial standards and other statistical aids, this unit could be invaluable to the Commission during rate hearings. By providing bench marks on which to gauge the performance

of utilities in South Carolina, the Commission would be in a better position to grant or deny rate increases.

At this time, the position of Utility Economist has been filled.

(7) AN ENVIRONMENTAL ENGINEER REPORTING TO THE EXECUTIVE DIRECTOR SHOULD BE ADDED (P. V9)

CM&P recommended hiring an Environmental Engineer to evaluate Federal and State environmental programs and requirements.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Council's examination of PSC operations indicated that the existing Commission staff is currently performing essentially the same functions that would be required of the Environmental Engineer, and that the functions of other government agencies, such as the State Department of Health and Environmental Control, might be unnecessarily duplicated by such an addition. Water quality, pollution from power plants and other environmental problems are already subjected to close scrutiny by various governmental agencies and private environmental groups. Information concerning any of these areas is available from the agencies mandated to perform these functions.

In addition, this position was not considered a priority by Public Service Commissioners.

The Legislative Audit Council does not concur with this CM&P recommendation.

(8) A POSITION OF CHIEF ENGINEER SHOULD BE ESTABLISHED (P. V9)

CM&P recommends hiring a Chief Engineer to provide technical assistance and to evaluate and enhance the performance of technical staff.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Council agrees that a Chief Engineer could be a valuable asset in helping to ensure that the engineering aspects of rate case and monitoring procedures are carried out as efficiently and effectively as possible. The addition of an essentially technical, supervisory level position should serve the public interest more than additional administrative personnel. This position has been created and filled.

(9) TO IMPROVE PUBLIC CONFIDENCE, A PUBLIC COUNSEL SHOULD BE ESTABLISHED (P. V9)

The CM&P recommendation called for establishment of a Public Counsel within the Public Service Commission to be appointed by the Attorney General but operate under the direct supervision of the Public Service Commission in regulatory matters.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Code of South Carolina (Section 58-62) requires the Attorney General to "...represent and appear for the people of the State and the Commission in all actions and proceedings involving any questions of general and public interest within the jurisdiction of the Commission...". In the past the Attorney General's staff has appeared at rate hearings in support of the people; however, it is not always possible for an Assistant Attorney General with other responsibilities within the Attorney General's Office to devote full time to rate proceedings.

In the absence of such assistance from a public consumer counsel, the consumer rarely has access to a level of legal expertise equal to that available to the utility company. It is especially important to note that in the final analysis the consumer pays for the legal representatives used by the utility company when paying a bill, yet, in most cases, consumers are not able to afford such representation for themselves.

The Legislative Audit Council agrees that the need for a consumer counsel is demonstrable and that an increase in the level of public representation before the Commission should result in an increase in public confidence. The Council has made specific recommendations in this area (see p. 43).

(10) MOST CASES BE HEARD BY A SINGLE COMMISSIONER, WITH THE
CHAIRMAN ASSIGNING CASES TO EACH COMMISSIONER (P. VI0)

CM&P recommended that the need for full Commission hearings be reduced and that more cases be handled by one or a few Commissioners.

LEGISLATIVE AUDIT COUNCIL COMMENT

Under current procedures the Commission is split for cases that involve smaller utilities and those that are scheduled so as to preclude full Commission attendance. In some instances the Commission staff conducts all or a part of these hearings and submits findings to the Commissioners for final approval. The full Commission is used whenever possible, especially for major cases.

Major rate cases require large amounts of staff input and usually result in decisions affecting many people and involving large sums of money. Hearing more than one major case at a time would result in the necessity to reduce staff time available for the individual cases.

Splitting the Commission would result in fewer Commissioners being involved in decision-making for the individual cases. It would also be possible for a Chairman to appoint Commissioners who would be either sympathetic or unsympathetic to the company depending on the Chairman's desires.

The Legislative Audit Council recommends that the current practices be retained and that the Commission continue to utilize the split Commission and/or staff hearings whenever appropriate.

(11) A PRECEDENT MANUAL SHOULD BE DEVELOPED AT ONCE (P. VI1)

CM&P recommended that the Public Service Commission develop a precedent manual including summaries of previous decisions and precedents in rate hearings and information concerning issues and criteria for decision-making utilized by the Commission.

LEGISLATIVE AUDIT COUNCIL COMMENT

Precedent manuals are an important tool for use by persons appearing before decision-making bodies and are widely utilized in the judicial system. In addition to providing information about past decisions and the basis for those decisions, a "Precedent Manual" would provide data on the Commission's work in general. Such data would be valuable to both the public, and to the Commissioners themselves in the decision-making process.

Attorneys and other persons appearing before the Commission would have available to them complete and up-to-date descriptions of earlier proceedings upon which to base their cases. Commissioners would be able to examine cases occurring before and during their incumbency, thus

enabling them to base decisions on appropriate precedents more easily and cite these precedents more readily. Information concerning decision-making methods, criteria and issues would be more readily available to the public.

Currently, the Commission's General Counsel is in the process of developing a precedent manual. This effort should be continued with special attention being paid to making the manual understandable to persons appearing before the Commission. The manual should also provide general information on issues and decision-making criteria and such information should be available to the public either as the complete manual or as excerpts from it.

(12) PUBLIC INFORMATION DISSEMINATION SHOULD BE SUBSTANTIALLY IMPROVED (P. VII-13)

CM&P's proposal called for setting up a Public Affairs unit responsible for informing the Commission of public concerns and informing the public of the Commission's activities and of current issues and problems in utility regulations.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Legislative Audit Council feels that this expenditure is warranted. Increasing public confidence is an important goal and consumer information can help to achieve this goal. Greater understanding of certain key issues, especially the necessity for maintaining the viability of utility companies, should increase the public's understanding of the problems of utility

regulation. In addition, a better knowledge of consumer concerns should make the Commission itself more responsive to these concerns.

(13) YEARLY GOALS AND OBJECTIVES SHOULD BE DEVELOPED FOR EACH MAJOR FUNCTION UNDER THE LEADERSHIP OF THE EXECUTIVE DIRECTOR (P. VI3 & 14).

CM&P recommended that PSC develop goals and objectives based on the mission statements recommended earlier (see above p. 84). These objectives should be so designed as to specify procedures and criteria for measurement of goal achievement.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Legislative Audit Council agrees with the necessity for, and desirability of such formalized objectives, and with the goal of relating such objectives to budgeting and to evaluation criteria. PSC should continue to develop written objectives and should relate them to budget requests and to criteria for evaluating procedural and program effectiveness. In this way the agency would be more accountable for its utilization of public funds and for the level of service it provides.

(14) THE TRANSPORTATION DIVISION'S MOTOR CARRIER INSPECTION FUNCTIONS SHOULD BE TRANSFERRED TO THE HIGHWAY DEPARTMENT (P. VI4 & 15).

CM&P recommended that motor carrier inspection be transferred to the Highway Department to increase career opportunities for transportation inspectors and for highway patrolmen.

LEGISLATIVE AUDIT COUNCIL COMMENT

While the Council feels that this motive is valid, the citizens of the State would be better served if such a step were contemplated as an attempt to unify transportation related functions under a single transportation agency. For example, truck inspections are conducted by PSC, yet weight inspections are done by the Highway Department. It would appear that such related functions would be carried out more efficiently by a single State agency such as the Highway Department and that this recommendation is more valid if increased efficiency and non-duplication are used as criteria for implementing it.

(15) A COMPLETELY REVISED STATUTORY BASE SHOULD BE PREPARED FOR LEGISLATIVE CONSIDERATION (P. VI5 - 17).

CM&P recommended that special attention be paid to recodifying the statutes governing the Public Service Commission in such a way as to unify them and to provide mission statements and overall goals for the agency. CM&P also recommended examination of the Commission's jurisdiction especially as concerns smaller utilities.

LEGISLATIVE AUDIT COUNCIL COMMENT

Legislative Audit Council's analysis of the statutes governing the operations of the Public Service Commission indicates that the statutes are redundant, disjointed and do not adequately define PSC's mission. Some of the statute sections are obsolete (e.g., sections governing street railways).

It appears that the main reason for this condition is that statute sections have been added or repealed over the past eighty years with little apparent effort to ensure uniformity, clarity or to define PSC's mission in other than a procedural manner.

These procedural statements (e.g., regulating rates) do not provide the overall guidance that statements of overall goals would (e.g., ensuring adequate service at the lowest possible cost to the consumer). Better definition of agency goals would also make it easier to evaluate agency effectiveness in achieving those goals.

The Public Service Commission has taken steps toward recodifying and simplifying the statutes during the past few years. These efforts should be continued and the results presented to the General Assembly as soon as possible. Every attempt should be made to substitute statements of overall agency goals for procedural statements. All obsolete and redundant sections should be repealed.

(16) THE COMMISSION SHOULD BE RESTRUCTURED, WITH FIVE MEMBERS SERVING FIVE-YEAR TERMS (P. V17 & 18)

GM&P recommended that the Commission be reduced to five members and that terms be extended from the present four years to five years with a Commissioner elected by the General Assembly each year from the State at large.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Legislative Audit Council has commented on this area (see p. 98).

(17) A MAJOR EFFORT SHOULD BE UNDERTAKEN TO RECRUIT AND TRAIN
QUALIFIED PROFESSIONAL ENGINEERS (P. VI8 & 19)

CM&P recommended that present engineering qualifications and capabilities be evaluated and that a staff development plan be implemented.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Legislative Audit Council agrees that it is necessary to ensure a high level of staff capability, but that efforts in this direction should include all professional staff, not just engineers. In no case should staffing commitments exceed the foreseeable requirements of the Commission's responsibilities and caseload. Any overreaction to current regulatory problems would not be in the public interest.

(18) A SUBSTANTIAL LONG-RANGE ECONOMIC RESEARCH PROGRAM SHOULD
BE ESTABLISHED (P. VI9-21)

CM&P recommended that PSC undertake a study of methods for minimizing rate increases in the future.

LEGISLATIVE AUDIT COUNCIL COMMENT

The Council agrees with the necessity for ensuring that adequate supplies of electricity are available at the lowest possible rates, and that PSC should take every step available to achieve that goal. However, PSC should utilize all expertise available from State agencies and education institutions, and Federal and private sources prior to committing the citizens of the State to additional expenditures for such a study.

In addition, PSC should carefully evaluate its current rate-making philosophy in light of future needs.

CHAPTER VI

LEGISLATIVE AUDIT COUNCIL COMMENT - COMMISSIONER SELECTION PROCESS

The Legislative Audit Council did not fully analyze the impact of the process used to select Public Service Commissioners on the ability of the Commission to effectively serve the public interest. However, certain factors concerning selection of Commissioners merit examination by the General Assembly and are presented in this Comment.

The process for selecting Public Service Commissioners should ensure that:

- (1) Commissioners can function in an environment free of pressure from the adversaries in rate cases;
and
- (2) Commissioners are representative of the public whose interests they serve.

Each of these factors is important in ensuring the highest possible level of regulatory effectiveness.

Independence

The importance of independence can best be illustrated using a judicial model. The process by which Commission decisions are made is, in essence, a judicial one. This process is characterized by the presence of the Commission itself which hears evidence and information presented by the parties to the proceeding (usually the utility company, persons representing the Commission staff, and persons protesting the rate increase requested by the company). Systematic procedures for presentation of evidence and information are utilized, and the decision of the Commission is based on the

weight and accuracy of the evidence and information presented as applied to the appropriate laws and regulations. It is generally accepted that the Commission should be able to operate in an atmosphere independent of pressure from, or obligation to, the parties to the proceeding.

Since Public Service Commissioners perform a quasi-judicial function, it is reasonable to guarantee the same independence for them as is expected in the judicial system. Long judicial terms and freedom from the pressures of the re-election or re-appointment have long been considered important factors in judicial independence. Many judges serve for life while many others serve terms of ten years or more. (U. S. Supreme Court Justices serve for life, S. C. Supreme Court Justices serve ten-year terms). In South Carolina, Public Service Commissioners serve four-year terms. This is a short period of time when compared to the terms served by many members of the judiciary. Longer terms for at least a portion of the Commission should help to insulate the Commission from outside pressures.

Representativeness

Government in the United States is based on representation of the people. The actions of regulatory agencies affect the everyday lives of the people and such actions are supposed to be in the public interest.

Factors such as public information and consumer representation are directly related to public input into the regulatory process, but it is also important to ensure that the Commission is receptive to that input. Representativeness is a primary factor in ensuring that regulatory Commissions are receptive to public input.

Representativeness can be defined in several ways. Legislative bodies generally represent people on a population or "one person - one vote" basis. In addition, representativeness can be based on the characteristics of the population as a whole (e.g., the presence of women, minority groups, etc.).

Selection methods also affect representativeness. Many representative bodies are elected directly by those represented. Under our political philosophy, this method is defined as more representative than appointment or election by an intermediate person or group.

In South Carolina, Public Service Commissioners are elected by the General Assembly. This method is used in only one other State (Virginia). Thirty-four states have Commissioners appointed by the Governor. In 14 states, regulatory Commissioners are elected by the public.

In addition, the current Public Service Commission districts do not ensure that the Commission represents the people of South Carolina equally. Current Commission districts are based on Congressional Districts as constituted in 1930. (In 1932, the State was redistricted into six Congressional Districts currently ranging in population from 410,999 to 446,267 [1970 Census]). If one defines representation in the "one person - one vote" sense, each Commissioner should represent a district of approximately equal population. This is not the case in South Carolina. The Seventh and Fourth Districts have about 501,000 and 493,000 people, respectively, while the Second and Fifth Districts have populations of only 243,000 and 284,000. (S. C. Statistical Abstract, 1975.) Representation can also mean that the agency is representative of the interests or characteristics of the people it represents. Since there are no

women or minority group members on the Commission, this second definition cannot be satisfied either.

Public Confidence

High levels of independence and representativeness are important in ensuring increased regulatory effectiveness, yet they serve another equally important purpose; increasing public confidence. When citizens perceive that their government is not independent of special interests and not representative, their confidence in that government may be diminished.

It should be noted that it is often unnecessary for any conflict of interest or lack of representativeness to be proven. The public bases many of its attitudes on the potential for such a situation rather than its actual existence. This attitude is completely understandable given the political occurrences and news media coverage of the recent past. Public confidence is best served if the selection process is untainted by the potential for questionable loyalties.

If the South Carolina Public Service Commission is to serve the public interest effectively, there are many improvements it must make; but, in the final analysis, it is the responsibility of the elected representatives of the people, the General Assembly, to ensure that the Commission is selected in such a manner as to be independent, representative and worthy of the public's trust.

Conclusion

The Legislative Audit Council has examined the utility regulatory bodies in many other states. It was noted that the problems

encountered in South Carolina are quite similar to those in other areas of the country. In attempting to solve these problems, several trends are noticeable. Governments, consumer groups and professional organizations are seeking to make regulatory bodies more accountable to the people whose interests they serve. In this way they hope to achieve a level of public confidence in regulatory bodies that has not previously existed. Many of the solutions implemented or contemplated have been designed to increase independence and representativeness with the ultimate goal of increased accountability.

In South Carolina, the General Assembly has been considering this situation. The Committee to Investigate Electric Power Rates and the Structure of the Public Service Commission has introduced legislation and will issue a report on the Public Service Commission in the near future. In addition, individual legislation concerning the selection process has been introduced.

The Council feels that a timely decision in this matter is important for two basic reasons. First, it will end any uncertainty which may exist in the minds of the Public Service Commission. Second, it will demonstrate to the citizens of South Carolina a continuing governmental interest in their welfare.

RECOMMENDATIONS

- (1) THE GENERAL ASSEMBLY SHOULD EXAMINE AND ANALYZE THE NEEDS AND INTERESTS OF THE CITIZENS OF SOUTH CAROLINA CONCERNING PUBLIC UTILITY REGULATION USING THIS REPORT, INFORMATION ALREADY DEVELOPED BY THE GENERAL ASSEMBLY AND ITS STAFF, AND OTHER INFORMATION AS DEEMED APPROPRIATE BY THE

GENERAL ASSEMBLY. THE GENERAL ASSEMBLY SHOULD THEN DETERMINE IF THE PUBLIC INTEREST IS BEST SERVED BY:

- (a) ELECTION OF PUBLIC SERVICE COMMISSIONERS BY THE GENERAL ASSEMBLY AS IS THE CURRENT PRACTICE;
 - (b) ELECTION OF PUBLIC SERVICE COMMISSIONERS BY THE PUBLIC;
 - (c) APPOINTMENT OF PUBLIC SERVICE COMMISSIONERS BY THE GOVERNOR; OR
 - (d) SOME COMBINATION OF THE ABOVE ALTERNATIVES OR OTHER ALTERNATIVES, FOR EXAMPLE, ELECTION OF THREE PUBLIC SERVICE COMMISSIONERS BY THE PUBLIC AND FOUR BY THE GENERAL ASSEMBLY.
- (2) IF PUBLIC SERVICE COMMISSIONERS ARE TO BE SELECTED FROM DISTRICTS, THE DISTRICTS SHOULD BE DESIGNATED ON THE BASIS OF EQUAL POPULATION.
- (3) NO CANDIDATE FOR SELECTION TO THE PUBLIC SERVICE COMMISSION SHOULD HAVE AN INTEREST, FINANCIAL OR OTHERWISE, IN ANY UTILITY UNDER THE COMMISSION'S JURISDICTION, OR ANY RELATED ENTITY, FOR A PERIOD OF FOUR YEARS PRIOR TO HIS/HER CANDIDACY NOR DURING HIS/HER INCUMBENCY.
- (4) THE GENERAL ASSEMBLY SHOULD SPECIFY TERMS AS APPROPRIATE TO THE CHOSEN SELECTION PROCESS.

APPENDIX

PUBLIC SERVICE COMMISSION COMMENTS

ON AUDIT REPORT

Need for Increased Emphasis on Efficiency in Rate-making (P.S.C. Report, P. 37)

We find under the title of "Need for Increased Emphasis on Efficiency in Rate-making," a summary on page 4, again repeated on page 34, with referenced supporting material on page 57. The philosophy of the Commission is and has been to emphasize in the strongest possible manner the importance of providing the best possible level of service for the lowest possible cost.

The North Carolina Legislature enacted a law requiring that Electric Utilities operating in North Carolina would have to have Management Performance Audits prepared every five years. The management consulting firm and scope of audit would be determined by the North Carolina Utilities Commission. The North Carolina Commission chose the firm of Booz, Allen and Hamilton to conduct such audits on Carolina Power and Light Company and Duke Power Company. The South Carolina Commission, in recent orders to both Duke Power Company and Carolina Power and Light Company, requested that copies of these audits be furnished this Commission. These reports have now been received and the staff is in the process of evaluating them.

The Commission staff, as per the Commission's instructions, is now in the process of gathering information to present to the Commission for their determination as to whether such a management audit should be performed on South Carolina Electric and Gas Company.

Inadequate Legal Representation of Consumers (PSC Report, P. 43)

Titled "Inadequate Legal Representation of Consumers", a summary appears on page 4, and on page 35 with supporting material beginning on page 43. We do not disagree with the idea of a different approach to consumer legal representation. While the Commission is not charged by law to assume the role of consumer advocate, our staff and Legal Department have assumed an approach which would seek the lowest rate level possible for continued adequate service.

Lack of Information Concerning Consumer Interest and Commission Activities (PSC Report, P. 46)

On page 5, repeated on page 35, is a summary titled, "Lack of Information Concerning Consumer Interest and Commission Activities" with supporting referenced material beginning on page 46. We feel that we are independent of special interest, representative of our constituency, and well informed as to the issues involved in rate cases. We are also acutely aware of the needs and the wishes of the people. However, the needs and the wishes are often contradictory. "John Q. Public" needs adequate electrical power today, tomorrow, and ten years from now. He needs and wishes to have adequate power for himself, for his children, and for continued industrial expansion to provide a healthy economy, and continued employment for him and new jobs for his children. But seldom does he "wish" to pay a rate today which will allow for the desired tomorrow.

We agree wholeheartedly with the recommendation that we should establish a Public Affairs unit to accomplish the goals projected by you and we are hopeful that this year's Appropriations Act will contain the necessary funds.

Need for Generation/Purchase Mix Studies (PSC Report, P. 59)

We find under the title of "Need for Generation/Purchase Mix Studies," a summary on page 5 which references page 59, but which is part of the overall Chapter III, the examination of the fuel adjustment clause. The basic thrust of the analysis provided by this entire chapter is in substantial agreement with the Commission's position.

Examination of Administrative Procedures for Efficiency and Economy (PSC Report, P. 66)

Under various titles on pages 5 and 6, with references to various pages in the body of the report, Council commented on administrative procedures and needs. Comments in regard to these sections will be very brief. The Commission did not have the position of Executive Director prior to July 1, 1976. The Executive Director is now engaged in developing written administrative procedures in the areas of bookkeeping and property management. We are now keeping our own property records and they have been reconciled to the actual inventory of the agency. Recently, the Controller General and the State Auditor promulgated new procedures for all agencies in regard to travel, etc. The Executive Director is ensuring that these procedures are followed.

Review of Cresap, McCormick and Paget Management Report (PSC Report, P. 80)

Chapter V of the Council report reviews Cresap, McCormick and Paget Management Report. Many of the recommendations of the Cresap Report as updated in March 1976 have been accomplished. The position of Executive Director has been created, Rules of Practice and Procedure have been promulgated, a Research Department has been established, the position of Chief Engineer established, and a Precedent Manual is

being developed.

Transfer of Motor Carrier Inspection Function (PSC Report, P. 93)

We strongly oppose the transfer of the Transportation Division's motor carrier inspection function to the Highway Department. Most inspections which are performed by the Motor Carrier Transportation Division of the Public Service Commission are to determine if the product being hauled is within the certificated rights of the carrier. This requires constant communications with the Motor Transportation Division's office and is highly complex. To try to perform this function would seriously impede the Highway Patrol's ability to accomplish its primary objective.

Commissioner Selection Process (PSC Report, P. 98)

In regard to your final recommendation on page 98, we sincerely believe that our present method of election is the best possible way and has resulted in the selection of competent Public Service Commissioners. We would therefore request that this recommendation be eliminated or modified to give credit to a system that has performed well. We recognize the need for public confidence. We will work toward that end but would like to point out that a similar problem exists with every Commission in America. We quote from a letter written on March 14, 1977, by Gordon E. Bollinger, Chairman of the Montana Commission, which is elected by popular vote: "You may have seen in the NARUC Bulletin where Florida has a bill before their Legislature that would make their Commissioners appointed rather than elected. A similar bill is in our legislature but I doubt that it will pass. However, it does show that each state seems to be searching for the perfect way and as far as I am concerned, there just doesn't seem to be a perfect way."